COPYRIGHT ROYALTY TRIBUNAL

Garcia

---------------------------------------X

In the matter of:

COMPULSORY LICENSE FOR SECONDARY TRANSMISSIONS BY CABLE SYSTEMS; ROYALTY ADJUSTMENT PROCEEDING

:CRT Docket 80-3

---------------------------------------X

2100 K Street, N.W.
Room 610
Washington, D.C.

Tuesday, September 30, 1980

The hearing in the above-entitled matter commenced at 10:00 a.m., pursuant to adjournment.

BEFORE:

MARY LOU BURG, Chairman

THOMAS C. BRENNAN, Commissioner

CLARENCE L. JAMES, JR., Commissioner

FRANCES GARCIA, Commissioner

APPEARANCES:

FRITZ ATTAWAY, Attorney-at-Law
Counsel for Copyright Owners

STUART F. FELDSTEIN, Attorney-at-Law
Counsel for NCTA

C O N T E N T S

P R O C E E D I N G S

CHAIRMAN BURG: All right, Mr. Attaway you may continue with your witness, Mr. Korn.

MR. ATTAWAY: Thank you.

Whereupon

ALEXANDER KORN

resumed as the witness and, still under oath, was examined and testified further, as follows:

DIRECT EXAMINATION (continued)

BY MR. ATTAWAY:

Q Mr. Korn, yesterday you spoke about the CPI and recommended use of the CPI as a yardstick to measure inflation in this proceeding. You also talked about the PCE recommended by Mr. Crandall, and you listed the advantages of the CPI over the PCE.

Before we go on to the next topic,would you give us an indication of how the CPI and the PCE have increased since the base period we are concerned with here to the present?

A I just happened to have written them down. The actual don't mean too much because you are converting it all to base October 1976. So, I would not worry too much about what the actual numbers were.

For the record and for your information, the CPI went from 173.3 in October '76 to 242.5 in April 1980 for an increase of 39.93 percent. During the same period the PCE increased 31.75 percent. The latest figure available is July 1980, and to bring you up to date, I calculated the increase from October '76 to July 1980, which is 42.99 percent for CPI and 33.98 percent for the PCE.

In order for this not be confusing on what goes on from here on, I want you to know we will use one set of numbers so that you, of course,will be using the latest set depending on what period you are going to be talking about, whether it's going to be the second half of 1980 or the first half of 1981.

For the rest of this discussion we won't use the PCE at all and we will use only this set of numbers down to here. (indicating) I did not have anything later at the time I prepared this. So, what we will be talking about is an increase in the CPI of around 40 percent.

Q Mr. Korn, before you address yourself to the adjustment necessary to maintain the real constant dollar level of the royalty fee, would you address the adjustment that must be made to the small system dollar sealing in the statute, the $80,000 and $160,000 levels that also must be adjusted in the proceeding?

A Right. The statute says, "The gross receipts limitation established by Section 111, (d), 2 CI shall be adjusted to reflect national monetary inflation or deflation, or changes in the average rates charged cable systems subscribers," and then it goes on. "To maintain the real constant dollar value of the exemption provided by such section.

So, therefore, two things have to be taken into account, the maintenance of the real value of the dollar and the average subscriber rates." It seems to me what act has intended to do was really protect the small cable systems rather than the copyright owner, and to protect them from the fact--from the possibility that they will be thrown into a higher category just because they raise their rates.

The simple interpretation that I have of this is that the intent was to raise the $80,000 and $160,000 limitations in accordance with the raise in their rates. If a cable system actually raised their rates, say, by 40 percent by October, they should stillbe in the same category that they were before because they have kept pace with inflation. They have not exceeded it.

Likewise, if a cable system raised their rates only ten percent since last October, then their limitation should just be ten percent above the $160,000 limit.

Q Mr. Korn, you're referring to October of '76?

A Right. So, my interpretation is that the--since on the average the rates increased 39.93 percent, you take the limits. $80,000--I'm sorry. On the average the cable rates increased 15 percent, which was the figure that you had yesterday pretty consistently from $6.60 to $7.50, about 15 percent. Then on the average you would simply apply that to the $80,000 limit and $160,000 limit.

The $80,000 would then become 92,120, and the $160,000 would become 184,240. Now, you might say where does the inflation come in? Well, it seems to me that the inflation factor would be that if they raise their rates higher than inflation, in other words, if a system went higher than inflation, that should throw him into a higher bracket because he went up faster than inflation. And therefore, inflation is the top level. If the average exceeded inflation, then inflation would have been--the 1.40 would have been the proper level rather than the 1.15, which is the level that the rates actually went up. Now, of course, that's treating it on an industry wide basis. You do have a problem because some cable systems have raised their rates faster than others.

But on an industry wide basis, that's the way I would recommend that you handle it. In other words, the average increase in cable rates was 15 percent since October '76. Therefore, the gross revenue limitations will be, likewise, raised 15 percent for the current period.

If you do it semiannually, you have to find an average increase in rates and publish the new gross limitations. In each case, it would go up with the average increase in rates.

Q Mr. Korn, are you recommending an industry wide adjustment or an individual adjustment?

A No. I'm explaining both possibilities, but I am recommending a cable system by cable system adjustment, which has many advantages as you will see. You have solved some of the problems we talked about yesterday. You also solved the problem of where do you get the figure on the average cable rates.

Each cable system knows its own rate, but there is no real current figure on average industry cable rates.

Q Mr. Korn, in the questionnaire, the cover letter to the questionnaire that the Tribunal sent out earlier this year, the Tribunal said, "The Tribunal is also required to consider adjustment of the special small system of gross receipts limitations to insure the systems of the size entitled to the exemptions in 1976 continued to be so entitled."

Does your recommendation precisely do what the Tribunal suggested be done in this sense?

A I think that's the interpretation that fits that description and also fits the intent of this section of the Act. In other words, in general that a system is not thrown into a higher category simply because it raised its rates, unless it raised it them so fast it exceeded inflation. That's the thing that this whole theory is based on.

Q According to your recommendation, the cable system, with the same number of subscribers had in 1976, carrying the same number of distant signal as it did in 1976, would be precisely in the same category it was in 1976 unless it raised its rates higher than the rate of inflation?

A Correct.

Q Thank you. Now turning to the real constant dollar adjustment of the royalty rates, would you first of all describe the base that the Tribunal should look to in making this adjustment?

A. We are talking about the larger systems now, the Form Three systems. Section 801 describes pretty clearly what is to be adjusted, and it seems to me that it's the fee schedule that you have to adjust. It says that the adjustment is for "the rates established by Section 111, (d) 2 B." And that is the DSE schedule rates.

Secondly, the Act permits the Tribunal to consider the two elements we just discussed, the national monetary inflation or deflation. In this context, it simply means a change in the CPI, in other words, the 40 percent increase. The second is the change in the cable rates.

Now, assuming the prices in general have increased by 40 percent since October '76 to the first half of 1980, and the cable system was paying 1.1 percent of its base revenues for two DSE's as royalty fees, now this same cable system should be paying 40 percent higher rate all for the current period, or 40 percent higher than 1.1 or 1.54 percent.

If the rates are charged per subscribers, the basic service did not change, I don't think there is too much question about that. Now, we come to the second element, the average rates charged to cable subscribers for the basic service.

Let's get back to our example. Assuming , again, that prices in general increased by 40 percent from October '76 level and the cable system was paying a copyright fee of 1.1 percent for two DSE's in October of '76, but this cable system had increased its subscriber charge of basic service form $5 and $7 in current period, the Tribunal can take this into account by saying that because the system increased the subscriber fee by 40 percent and thus kept pace with inflation this should be no increase in the DSE's percentage. In other words, he would have no adjustment. He has kept pace with inflation. I would concur if you did that.

Q Mr. Korn, how should the adjustment that you have recommended be made; should be the same for every cable system, or should it be tailored to each individual cable system?

A Before I go into a little detail on that because we are going to be talking about changes in percentages and I'm going to introduce Exhibit 14 which you have in front in you, let me just briefly say that you have to be very careful when you deal with percentages, percentages based on something, based of something, and if you are talking about just percentages you have to know what they're of because you can't just add or subtract them unless they are of the same base, based on the same period.

For example, let's say somebody had a $10 rate in 1976 and in 1980, it was $15. Now the change is $5. Now, if I asked anybody in this room what percent change was there in the rate from '76 to '80, I'm sure everybody would say plus 50 percent, increased it 50 percent.

If I said what is the 1980 figure compared to '76, you would say 150 percent. Now, it is 150 percent. Now, what we don't normally think of, but which is understood when we say that, is that the base is 1976. It is 50 percent of the 1976 base, 150 percent of the 1976 base. So really what we have to remember is with respect to 1976 when we talk that way. Now, just converting these into, instead of percentages let's make it decimals, it's easier to figure, and that's what we will be using from now on. 50 percent is .50. So 50 percent of 150 is 1.50. Sometimes it is necessary to look at the change or this figure here,not with respect to the old base, but with respect to the new base. So, if I asked you, now, what is the change with respect to 1980, I am sure everybody would say it's .50 over 1.50, or 33 1/3 percent. Right?

In other word, the change, looking at it from 1980 figures is 33 1/3 percent. Now, this is with respect to 1980. So, if we have a change on one base and we have the figure which shows what it is at that time, we simply divided the change by that figure to get the change of the new base. In other words, 50 is 1/3 of 150. Everybody knows that. So the way you do it is just divide by 150. With that in mind we will hand out Exhibit 14 which will now describe the adjustment in general.

(CO's Exhibit No. 14 was marked and received in evidence.)

THE WITNESS: Actually, this adjustment will be the same one being made for the overall average or the individual systems. This explains the adjustment. The first line shows the average cable rates per subscriber. That was discussed yesterday. The averages I have used are the ones that Alan Cooper summarized from the CRT questionnaire, the $6.60 in October of '76. The CPI, as we just discussed, went up 39.931 percent. I'm now at the point where it says adjustment of DSE s for Form Three systems. We take the CPI increase of .399 and substract the cable rate increase of .515, the difference to be adjusted for is .2478. In other words, 25 percent. Now, were we to apply that to the 1976 revenues, that would be the proper figure, but we know we are going to apply it to 1980 revenues.

We have to convert this difference from October '76 to April '80 base because it will eventually be applied to the 1980 revenues. Now we do that the same way we did this. We divide it by the 1.1515, which is the new 1980 figure in terms of the old, to get .2152. So, for Form Three system, you simply add 21 percent to the--that would be your surcharge to the DSE schedules. So instead of .675, it becomes .675 multiplied by 1.2152 or 82, and the two signals, the same procedure, et cetera.

On the same sheet, so that you have it in front of you, I showed again how we would adjust the borderline for the small systems. Take the present $80,000 and multiply it by the increase in cable rates to get 92,120.

Q You have just described what the Tribunal could do if chosen to make an overall industry adjustment to the royalty rates. However, you said it before, this is not what you're recommending. What are you recommending?

A I'm recommending that the same procedure be essentially used on a cable system-by-cable system basis, and that by simple change in your Form Three, which change I will illustrate with the worksheet I have, it will be possible for each system to have it's own adjustment based on its on cable rate increase. The reason for that is that although it doesn't really make to the copyright owner, I would think, whether you do it one way of the other, it does make a difference to the cable system because a cable system that had a very small increase in its own rate would be getting the benefit of the average adjustment, which may be much larger . At the same time, it's base would be small because it did not increase its cable rates.

So it would be getting sort of a double benefit of it. On the other hand, they would not care. On the other hand, those cable systems that did increase its rates substantially would be paying,not only the average surcharge,but his base is increased because he has increased his rates, he has paid on a higher base, and therefore,he certainly wouldn't like it. It also solves many problems when you do it on an individual basis. For example, we discussed yesterday systems that have very low rates in basic tier service or charge zero, free basic tier service. And,you will see when we will get into it, those problems are solved and handled on an individual basis.

Also, I think the law itself says that if a cable system increased its rate to an extent higher than inflation you would only go to the inflation point. So, you certainly wouldn't want that. You would have to exempt them. If cable system increased its rates to exceed inflation, that it had no surcharge, it would use the old schedule. And I don't see how you could handle that on an industry basis. The cable system would have to be identified that it did increase its rate.

So, those are some of the reasons I believe that it should be done on an individual basis.

Q Mr. Cooper spoke about tiering in his testimony. You just mentioned the problems that could be met by a system adjustment. Would you describe the effects of tiering on future royalty payments?

A Now, when the Act was passed in 1976, all cable systems had a basic subscriber service consisting of local or distant signals only if you had pay channels as a second tiers of service at that time.

Now, the current trend, of course, is to go more into pay and to charge less for the basic service tier. But since we have 1976, October '76 base of, you might say, normal charges, you can use that fact if you work on an individual cable system basis to come out with the proper adjustment, even if the cable system had lowered its rates.

If you do it on a cable system basis, then any cable system that had lowered its rates would have to have a greater offset in its inflation surcharge. It automatically comes out that way as you will see. In other words, this method keeps the value of the royalty fee the same except for the change of inflation, in other words, in constant dollars, exactly what the Act tells you to do, whether the cable system increased its rates, kept them the same or even lowered them.

Furthermore, the other problems with the tiering is the fact that some of them may give free service for the basic charge. You can easily have that system come up with a base which you would describe based on the average revenue per subscriber for the industry times the number of subscribers he has.

For example, for 1980 it would be around--we get to it later--but I think it's around $7. So, the cable system would simply use as his revenue against which to apply the percentage a constructed revenue which would be $7 times six months times--and then multiply. That would be the revenue which you would then apply to the royalty percentages.

Q So, what you are recommending is a way of meeting the concern of Congress expressed in the House Report that cable systems may reduce their basic charge as an inducement for individuals to become subscribers to additional subscribers. What you are doing is, by recommending a system-by-system adjustment, you are only adjusting the rates for those systems that have actually changed their subscriber base as

Congress thought they might and adjusting their rate precisely to make up for that change.

A That's right. The adjustment would be, not only for inflation, but the offset to that inflation adjustment would take into account the cable rates. If they increased, it would be a deduction from inflation. If they decreased, it would be an addition to inflation. And that effect is that the net change always reflects the particular cable system's own change rates even if they go down.

Q If royalties are to be adjusted by each individual cable system, based upon its basic rates in 1976, how do make this adjustment for cable systems that are new and didn't exist in 1976 or cable systems that have no 1980 rate to compare with the 1976 rate?

A Those that did not exist in '76, they do have a 1980 rate, and they also have 1980 revenue figures against which to apply it. The only thing that I'm missing is the 1976 rate from which to measure their current rate. I would just assign to them the average industry rate of $6.60.

Q What about systems with no 1980 rate?

A Systems with no 1980 rate, because they have a zero rate, I would simply assign to them the same figure for 1980, $6.50. That sounds strange right off the bat. But when you think about it, the way the systems works out, if you have the same rate in '76 and '80, both, then you would get the full effect of inflation. So, in effect, the system that has no

1980 rate will get the full effect of inflation if you assign the same $6.60 for 1980 rate.

COMMISSIONER GARCIA: Explain that to me. How does a system not have a 1980 rate?

THE WITNESS: They may have free service in 1980 for the basic rate. This may just be theoretical up to date. But for the next five years, as you have seen in these franchise applications, it is very likely to happen.

MR. ATTAWAY: Madam Chairman, we discovered an error in the next exhibit we would like to present. May we have a five-minute recess to discuss this with Mr. Korn before we proceed?

CHAIRMAN BURG: Of course.

(A brief recess was taken.)

BY MR. ATTAWAY:

Q The statute provides for a rate review proceeding every five years to adjust for inflation in changes into average charges to subscribers. If the adjustment to be made this year does not contain a further periodical adjustment for increases in inflation, what will the effect be on these subscriber payments made between 1980 and 1985 in terms of coming up with real constant dollar value? In other words, will the purpose of the statute to maintain the real constant dollar value of the royalty payment be met if a one shot, one-time adjustment is made in 1980 without any further adjustment during the intervening years to 1985?

A No. As you can see, the one shot adjustment would not have worked during the period October '76 to date because they are 40 percent behind right now. No one knows how fast inflation is going to increase over the next five years, but it is definitely going to go up. The difference, of course,will be if it makes the one shot adjustment, that adjustment will apply for every semiannual reporting period and every semiannual royalty fee. But if you adjust it every semiannually, it will go up with inflation.

I did some rough calculations which I understand have to be revised because we took a yearly figure instead of a semiannually figure. But it would be in the neighborhood of the next five years of 12 percent, a $12 million difference in royalty fee assuming a fairly conservative investment of about eight percent inflation rate.

CHAIRMAN BURG: So you are saying adjust this as you go.

THE WITNESS: The same way you do the music fees--

CHAIRMAN BURG: Doesn't that, in effect obviate the need for a five-year review?

THE WITNESS: I would assume in a five-year review you would get into basic questions like today. Are we doing it right? What are the things that have happened in the industry It might work out that you might not need a five-year review. It may work out splendidly, I don't know. But certainly it won't work out with a one shot adjustment for inflation. Just as you have done the non-commercial royalty fee annually, because they file annually, I would recommend that you do the same thing here. When the fee is filed semiannually, the adjustment should be made automatically, by your publishing the 1.40 or whatever the latest figure is that you are using for the CPI. I will show you how each cable system can make its own adjustment when it files its fees.

BY MR. ATTAWAY:

Q Mr. Korn, you estimated the shortfall from 1980 to 1985 would be in the neighborhood of $12 million. Are you prepared to demonstrate how you arrived at this figure in a submission to the Tribunal tomorrow once you have had an opportunity to revise the chart we found an error in?

A Yes. We will revise the exhibit and submit it for the record. I'm not sure it will come out exactly $12 million because that is a rough estimate based on the fact that we use a yearly figure instead of a half-year figure.

Q Mr. Korn, would you explain , demonstrate to the Tribunal, how each cable system can make its own adjustment to maintain the real constant dollar value of its royalty payment when it files semiannual payment of the account?

A To do that, I would like to hand out some blank worksheets which we can follow line by line.

MR. ATTAWAY: This is not an exhibit. It will be included in one of our subsequent exhibits. This is to help you follow his testimony.

THE WITNESS: I will give you the figures as we go along. I will also do the multiplications for you. The first line is the figure you will publish the same way you do on the non-commercial TV stations. The second line says, "October 1976 subscriber rate." Let's put in a figure of $6 there. The third line is the April 1981 subscriber rate. We are assuming here that this is for the first half of 1981 that we are filing for. I recommend you use the April figures both for the index and for the subscriber rate.

Let's say this system didn't change at all. It had $6 also. So, line three is $6. Line four says divide line three by line two. I won't do that for you. You can do that yourself. Six divided by six is one. Subtract line four from line one. That's .500. Line six says if line is zero or negative--well, that doesn't apply here. So forget that. Line seven says divide line five by line four. Well, line five is .500, and line four is one. So forget .500.

Now, this is the constant dollar surcharge rate for this particular system. You can see it is probably right because the system did not change its rate. Therefore, you get the full effect of inflation which, in this case, is 50 percent as you can see from the first line.

Now, let's work it out--no, let's not. Let's go to another page and take another example. I will give you the bottom filled out. You won't have to fill it out later. Let's go to another page and take another example. I will give you a hard one this time.

COMMISSIONER GARCIA: On the one we just did, where we were using $6, should we have used $6.60?

THE WITNESS: No, this is the actual rate. Each one will put his own rate in. I'm saying this particular cable system had a $6 rate which it didn't change over the period. This is not industry average anymore. We are talking about a system-by system--this would be part of your Form Three in other words. On the second sheet, again, we are starting with a 1.50 inflation rate. And this system had a $6 rate in 1976.

So, line two is $6. Line three, April 1981, the rate was $8. In other words, it had increased its rate from $6 to $8. Line four says divide line three by line two to three decimal places. I will do that for you. It's 1.333. Line five substracts line four from line one. You can do that yourself, but I will tell you the answers. It's 1.167. Line six says if line five is zero or negative do something. But it's not zero or negative. So just forget that. Line seven says divide five by line four. I will do that division for you. It's 1.67 over 1.333, and the answer is 0.125.

Now, that's the constant dollar surcharge rate for this particular system. In other words, if he had three DSE's and the old rate was 0.1525, the new rate would be 12 1/2 percent higher, whatever that comes out to. I will give you the actual figures in the exhibit.

The second half of this worksheet will actually demonstrate, when we get to the four different examples, that the royalty is constant dollars; in other words, it will only change by inflation, is kept constant if we take a system that has the same number of subscribers in other periods and the same number of DSE's.

I will now hand out Exhibit 16, which is the same worksheet, but they will be filled out and there will be a cover sheet on it which will give you the assumptions made in the illustration. This will demonstrate that the royalty fee per subscriber will remain the same.

(CO's Exhibit No. 16 was marked and received in evidence.)

THE WITNESS: Looking at the cover sheet only for a minute, the cable systems we are talking about in this illustration, the cable systems filing statement of account for the first accounting period in 1981, and it has 5,000 subscribers. It has a 1976 subscriber rate of $6 in each case. In other words, they all start out with the same subscriber rate. It has the same number of DSE's in both periods. As before, the constant dollar index determined by CRT, is 1.50, which is simply the CPI.

There is one more thing I want to say before we go into the example. The revenue in each case is intentionally set equal to the monthly subscriber rate times six months, times the 5,000 subscribers. In other words, in order to demonstrate the point, I have set the revenue in each case to be equal to the subscriber rate times six months, times the number of subscribers. So that if the real constant dollar value is maintained,we should get a figure here which is constant no matter whether the rates went up or down or stayed the same or whatever. We can almost guess at what the figure would be. In 1976, we know that the revenue is $6 times six months, times $5,000 or $180,000.

Now, $180,000 revenue with a three DSE percentage applied, that percentage being .01525, gives you $2745 fee. If there was one in 1976, you would have paid that. I'm going to guess at the answer and show you how to determine the answer before you start. So,this is very helpful. In other words, the 1976 fee would have been 2745 based on these figures.

Now, if inflation went up 50 percent, you would simply multiply that by 1.5, and you would guess, before you even start, that the constant dollar fee you are going to get in 1981 is 4117, 1.5 times $2745.

Now on the first page, my first example shows line two with a $6 rate and line three with a $5 rate. In other words, here is an example where in October '76 the cable company charged $6 but it lowered its rate for its basic service. Line three divided by line two is 8.33. Line five, therefore, becomes 667, that's .667. Line seven divided by line four is .80. So that the surcharge for this cable company is 80 percent. You notice that it's higher than inflation. Inflation is 50 percent. The reason for that is that he dropped his rates.

So, that is how it makes up for the drop in rate. Now, his gross revenue for the six-month period was $150,000. In order to see whether he's in the small system category, he has to find out what his borderline is. Line (b) says multiply line four, above, by $160,000. Line four, above, is simply his increase or decrease in rates. Therefore, his $160,000 went down to $133,000 because lowered his rates, keeping him in line with his own rates. He is not going into a different class because he changed his rates. Line (c) gives the royalty percentage for three DSE's, which is .10525. Line (d) is simply the same surcharge you found above, .80. And line (e) you multiply .80 by the royalty percentage to get the additional percentage which is .0122, and line (f) you add that to the royalty percentage to come out with an adjusted royalty rate of .02745, instead of the original one which is .01525.

When you multiply the adjusted royalty rate by the gross revenue, the result is in line (g), $4,117. So, this particular system would have to pay $4,117. Now, this is the toughest one. The others are easy.

MR. ATTAWAY: Before you go to the next table, let's spend a little bit more time on the adjustment of the small system ceiling, the system paid under the DSE schedule, or would have paid under the DSE schedule of 1976, right?

THE WITNESS: Right.

BY MR. ATTAWAY:

Q If there were not a downward adjustment of the sealing because it changed, it lowered its basic rates, it would receive the benefit of the small system exemption in 1980--

A Yes.

Q Even though its circumstances stayed the same, same number of subscribers, same number of DSE's, the only difference is it lowered its rate. So, without this adjustment, the cable system could achieve a benefit of the small system exemption by lowering its rates, all things remaining the same.

A That's correct. In other words, the $150,000 gross revenue in this period, would have brought it below $160,000 level. If you use an average basis for an entire industry, it would be higher than $160,000 because on the average, rates went up. Therefore, this system would fall into a smaller system category because it lowered its rates.

I think it was the intent of the Act and the reason they give you both the inflation and the rate adjustment in that paragraph, where it talks about the gross revenue levels, I think it was the intent that the systems be kept in the same category if they changed their rates. So they get the benefit. In other words, there is no change based on their change in rates in the category.

Q So, by making this downward adjustment, the $160,000, you are maintaining the value of that small system ceiling to that cable system?

A The relation to the cable system , to the ceiling is the same. Right.

COMMISSIONER GARCIA: Mr. Korn, how do we come up with the $42, or are you going to tell us that next?

THE WITNESS: I'm sorry. That's the exceptional case. We will get to that last. That has to do with tiering.

COMMISSIONER GARCIA: Are you going to show us how you get to that before you start?

THE WITNESS: Sure. The next example, which is really the one that you already did on part one, I won't go over that; the subscriber rates remain the same, $6 in 1976 and $6 in 1981. He, therefore, gets the full effect of inflation. Now, going down to Part two (a), his gross revenue is $180,000. Line (b), multiplying $160,000 by line four, above; line four is one, gives you $160,000. So, his gross revenue borderline stays the same, which is exact intent. In other words, if you went up with inflation, your borderline goes up with inflation correspondingly. If you stay the same, then your borderline stays the same.

Line (c) is the same. We are assuming the same number of DSE's and the same royalty rate. The surcharge is simply copied from above, .50. That's line (d). In line (e), we multiply the surcharge by the statutory royalty rate which gives .00763, and the adjusted rate is simply the sum of the two, the statutory rate and the adjustment. You get .02288, which is the adjusted royalty rate for this particular cable system. The royalty fee due is then multiplied by its revenue which becomes $4,117. So, you do notice that although the adjusted royalty rate is different in each case for each system, it is compensated for by the revenue gain or loss because it changed its rates.

Therefore, you come out with the same royalty fee due.

The next example in part one shows the case where the cable system increased its rate from $6, again in October '76, to $9 in April 1981. That is in Line four an increase of 1.500. Now, when you substract 1.500 from the inflation rate of 1.500, you would get zero. In other words, by increasing this rate 50 percent, he has kept right in line with inflation. So, he goes to line six. And it says if line five is zero or negative, in this case it was zero, you check here and skip to part two, below, because there is no surcharge. So he checks and he goes below. Now, his revenue was $270,000. His limit is determined in line (b) by multiplying $160,000 by line four, above, by one and a half, $240,000.

In other words, his went up strictly with inflation. Going to (c), again, we have the royalty rate and, of course, there is no surcharge in (d). So he pays the old rate. If you would multiply it out against his $270,000, you would come up with same fixed fee, royalty fee. This is the royalty fee per 5,000 subscribers remember, in each case. So, the royalty fee per subscriber is the same, too. That is exactly what the

Royalty Act say.

The next part we have the CPI change of 1.50. And in this case the subscriber rate went from $6 to $8, or an increase 1.333 in line four. Once subtracted, the result in line five gives you .167. Line 7 converting it to $81, 81 base, gives you 0.125. That means that there is a 12 1/2 percent surcharge. The calculation below show that the revenue for this system is now $240,000. When you multiply $160,000 by line four, above, which is its rate increase, in other words 33 percent increase, you get $213,000. So that would be his borderline.

Now calculating the actual royalty below the same way, you can have the fixed royalty fee plus the additional surcharge of .00191 . In line (e), it gives you a total of the fee adjusted to .01716. When that is multiplied by the $240,000 revenue, you, again, get $4,117. Before I go on to the exceptional cases of the zero base, which is what you asked me about, if you have a question, I will be glad to take it.

We can go over this and just look at the parenthetical expressions and tell you how you would treat the exceptional cases. Line two is the first one. In other words, normally, you would put your October 1976 subscriber rate there. But if you did not exist in October 1976, your new system, you don't have any.

The form tells you to use $6.60. As a matter of fact, it doesn't make any difference what that figure is. We just took the industry average, but it does not matter what it is because--I'm sorry. Excuse me. That is only if you had a zero rate. We used the industry average. So you would measure from the industry average. If your system had existed, you are assumed to have the industry average. You are offset against inflation is measured against that.

The next important parenthetical expression is not in parenthesis. It says--yes, it is. I'm sorry. On line three it says, "Your April 1981 subscriber rate, if zero, see note below." In other words, if you had a free basic service in April 1981, you use the figures in the note. And what the note says, in line three, in other words for April 1981 subscriber rate, use $6.60 The effect of that is to give the full effect of inflation. If you are on a new system and you came on with a free service, you would use $6 in line two because your a new system, you had none--$6.60, also $6.60 in line three because you had a zero basis. So, you would have a difference, zero, and you would have the full 1.5 effect of inflation. There is no offset for inflation.

COMMISSIONER GARCIA: Mr. Korn, number three there, when you say zero, you said 60. That's a design to pick up any tiers and free services?

THE WITNESS: Exactly, the basic service is free service, the basic tier. What do you do for revenues?

COMMISSIONER GARCIA: Excuse me. Before you go any further, why do we use $6.60 and '81?

THE WITNESS: I just explained that.

COMMISSIONER GARCIA: I know, but I did not understand.

THE WITNESS: Nobody had free service in October of '76, so, we are talking about new systems.

COMMISSIONER GARCIA: Yes.

THE WITNESS: A new system, we are told to put $6.60 in '76 in line two. We are also telling you to put $6.60 in 81, line three, so that the difference is zero and he will get the full effect of inflation. In other words, you won't have an offset. As a matter of fact, there is a page that shows that. If you look at the second one, if you have the same number instead of $6, it is the same number in both two and three. Divide one by the other, you would get one. You would end up by getting the 50 percent inflation charge. So, that system you get the actual effect of inflation.

However, there is another problem that is taken into account in the note. It says in line (a), "The gross revenues." If a system has free service, it has no gross revenues. Here, we have given it the industry average revenue per subscriber. This is for the six months. That is approximately $42. In other words, $6.60 plus six percent for second sets and other revenues, times six. That is $42 for the period.

CHAIRMAN BURG: Go over that again please?

THE WITNESS: We have taken the average industry revenues per subscriber, estimated as follows: $6.60 plus a 6 percent factor for second sets and other revenues. That gives you $7. So, the $7 times six months is $42. The notes tell you to use $42 times the number of subscribers. So, in that way, you construct a revenue base for the systems that had none.

BY MR. ATTAWAY:

Q Mr. Korn, isn't what you are doing for systems with November 1976 rate and November 1981 rate is require for them to pay statutory royalties on the real constant dollar value of the average royalty rate that did exist in 1976?

A On the average revenue, too; revenue per subscriber.

Q Right. The per value of that rate?

A That is right. In effect, we are constructing a '76 base, since we are increasing it to the full effect of inflation. That is exactly what we are doing.

MR. ATTAWAY: Before I go on, are there any questions from the Tribunal on these worksheets?

THE WITNESS: I might say that I have shown you, you might say on a common sense method, that he actually gives you the same royalty fee per subscriber. I have also you, by example, it comes out to the same per 5,000 subscribers. There is also mathematical proof, I can submit to the record, that will demonstrate that you get the same royalty fee per subscriber by using this method. Now, there may be simpler worksheets that you could do, the effect is the same, if you follow that procedure. Substract the two increases and use the difference converted to a current base. You can use that difference as your adjustment for your DSE schedule.

COMMISSIONER GARCIA: Mr. Korn, go over, again, your computations for that 1.5 starting of the CPI,your very first line one?

THE WITNESS: There is no computation for that. You publish that figure.

COMMISSIONER GARCIA: Was that on the previous page? Go ahead.

THE WITNESS: You want to know where that comes from?

COMMISSIONER GARCIA: Yes.

THE WITNESS: 1.5. The CRT issues a notice--

COMMISSIONER GARCIA: I mean this is just an example you have given us, right?

THE WITNESS: Yes. This is for future times. I just picked it out of the air. Right now it is only 1.399.

COMMISSIONER JAMES: You have mathematical justification that you can submit?

THE WITNESS: Yes.

COMMISSIONER JAMES: I think I would like to have that.

THE WITNESS: We are going to another thing.

COMMISSIONER JAMES: Mr. Korn, did you review the pleadings by NCTA earlier this year in this proceeding?

THE WITNESS: Yes, I did.

COMMISSIONER JAMES: Is it your understanding that NCTA interpreted 81(b), 2A differently than the way you interpreted it and have described here today?

THE WITNESS: Now, the Act says the adjustment is to maintain the real dollar level of the royalty fee per subscriber which existed at the date of the enactment of the act.

Now, as used here, I have interpreted royalty fee per subscriber really as royalty fee per subscriber for any given number of DSEs. It appears to me that NCTA interprets this as royalty fee per subscriber in dollars no matter how DSEs are being used.

I believe my interpretation is correct for several reasons. On the date of the enactment of the Act, there was no royalty fee in dollars; their gross base royalty fee. So, continuing certainly could not have implement the royalty fee in dollars that had to be kept constant but there was a DSE schedule which was setup. That is the thing that has to be kept constant. The value of the schedule when I applied to revenues under the NCTA interpretation, a cable system that holds its subscriber rate down for business reasons can increase the number of DSEs up to the rate of inflation--

MR. FELDSTEIN: Madam Chairman, pardon me for the interruption.

In addition to the legal interpretation of the Act which a person who has been qualified has been given, he is making purchases by NCTA which has not been given. It is going to be difficult to cross-examine him.

THE WITNESS: May I, instead of calling it the NCTA interpretation, call it where you talk about royalty fee in dollars rather than royalty fee schedules.

CHAIRMAN BURG: Let's restructure this line of testimony to compare the way we have interpreted this section which is to say royalty fee per subscriber given a constant number of DSEs against a different interpretation that may or may not be made by NCTA that the statute means to say royalty fee subscriber without regard to the number of DSEs is carried by a cable system or without regard to the number of programs not DSEs. DSE is a short way of saying programming here.

MR. FELDSTEIN: Counsel is attempting to rebut NCTA's case prior to NCTA making it. Counsel will have every opportunity to rebut our case after we have made it as counsel for NCTA has stated. We don't know what their case is. We have not seen it yet. We suspect, based on their previous submission, there may be arguments to this effect and we would like to compare our interpretation with another interpretation that may be made or that the Tribunal itself, maybe, made.

CHAIRMAN BURG: The Tribunal will overrule that objection.

Proceed.

THE WITNESS: So, the first confirmation I would say that our interpretation is correct is that the Act refers to the fee which existed at the date of the enactment of the act. That could not mean a dollar fee because there was none.

Secondly, a cable system by holding its subscriber rate down for any reason shall, probably, business reasons, can increase the numbers of DSEs carried with no penalty up to the inflation rate if the interpretation discussed is the one that you adopt.

Under this interpretation, it is possible to add DSEs whenever subscriber rates are lowered. If they decide to go to a lower subscriber rate or a zero subscriber rate, they can add an additional DSEs without an additional royalty payment.

I don't believe this was the intention of the Act which requires a separate rate payment for every DSE on a calculated graduated scale which is made quite clear in Section 111(d)2B.

Now, this point is very important now because there is greater interest in using DSE because of FCC removing these restrictions. Therefore, I believe the required adjustment is one that increases the DSE percentage schedule to keep pace with inflation after given credit for the increase in subscriber rates.

If the rates go up faster than the CPI, there would be no adjustment.

CHAIRMAN BURG: Under your recommended interpretation in your formula, is it true that copyright owners will receive the same, the 1976 constant dollar value of the royalty payment prescribed by the statute for the programs that are retransmitted by cable systems?

THE WITNESS: Yes, sir.

CHAIRMAN BURG: If an increase in the change of DSE programs is added to the waiver increase in rates, there may be, during the period between 1976 and 1980 and then adjusted to its present value, real constant dollars because there would be an increase in the programs carried, won't copyright owners receive less per program than they would under your interpretation?

THE WITNESS: Yes. The constant value, the constant dollar value, of the royalty fee per subscriber per program would decrease because the number of programs carried would increase without any charge.

MR. ATTAWAY: This concludes my questions.

CHAIRMAN BURG: Would you briefly list the recommendations that you have made to the Tribunal during your testimony.

THE WITNESS: Yes.

I think if you pass out Exhibit 17, they will have it right in front of them.

COMMISSIONER JAMES: He is going to give a summary now?

MR. ATTAWAY: Yes.

COMMISSIONER JAMES: I have been working with my calculator and I am confused about something. If you take Exhibit 14 and apply it to your example, what would that fee be, that that cable system would pay, that has 5,000 subscribers?

THE WITNESS: I'm sorry. What is the question?

COMMISSIONER JAMES: That was the straight adjustment across industry-wide.

THE WITNESS: Yes.

COMMISSIONER JAMES: If you applied that to your example, what would that cable system of 5,000 subscribers pay in royalties?

THE WITNESS: Well, how many DESs does it carry?

COMMISSIONER JAMES: You have three; right?

THE WITNESS: Use the same assumption as on here.

COMMISSIONER JAMES: Yes. Use the same assumptions you have on 16.

THE WITNESS: We have to figure out the revenues.

COMMISSIONER JAMES: 240,000.

THE WITNESS: No. 760 is the April, 1980, seven point sixty times the six, for six months, times 5,000; right?

So, the revenue is 228,180; is that correct?

COMMISSIONER JAMES: I don't know. I was having problems. That is why I asked you to help me with it.

THE WITNESS: Let me go over it again. The revenue was the 1980 rate of $7.60, 7.60 times six months, that is, and multiply that by 5,000 subscribers. That's 228, 180 in revenue.

If three DSEs is zero one. No. What is three DSEs?

COMMISSIONER JAMES: Five two five?

THE WITNESS: Right. The surcharge on this is 2152, two one five two, .01525 times 1.2152. So, it is rated on three DSEs which is 1.8531. That is percent.

COMMISSIONER GARCIA: Why don't you do it on the board for him?

THE WITNESS: It might be helpful to write it on the sheet.

If you look at Exhibit 14 where it says for three systems, schedule form three systems, add 21.5 percent to the DSEs. They don't have to be DSEs on here. So, let's write it on; three DSEs. The original rate is .10525 adding 21.5 percent to that. If my calculation is right, I'll do it again, we can write in 1.8531. That's the new rate.

The other figure that is missing is the gross revenue figure. As I said, we constructed that by taking the monthly cable rate and using that as your base. So, I reconstructed that by multiplying the cable rate of 7.606, in the first line for April, 1980, by six months and by 5,000 subscribers and I get 228,180 dollars.

When I multiply the revenue by the new DSE figure of 1.8531, I get $4,228 as a royalty fee.

COMMISSIONER JAMES: Play that by me. Maybe you can put it up on the board.

MR. ATTAWAY: Let me run through it by asking questions.

BY MR. ATTAWAY:

Q In Exhibit 14, you hypothesized an increase in DSEs of 15.150 percent and an increase in the CPI of 39.931 percent.

A 15.150 percent is increase in cable subscriber rates.

Q Right. You calculate a surcharge of .2152. Now, if this were applied on an industry basis, go to your first sheet of Exhibit 16, the cable system rates were lowered, and their growth 1981 revenues would be $150,000. You have already calculated its DSE or its DSE percentage assuming throughout this hypothetical cable systems are carrying three DSEs to keep it constant .0125 percent is what it equals.

If there was an industry-wide adjustment, won't you then multiply that percentage for three DSEs under the statutory schedule by your adjustment of 1.24781 and apply that adjusted percentage against the gross revenues of $150,000 and you would get a royalty payment of $2,779; is that correct?

A I did not follow it.

COMMISSIONER JAMES: I think he has asked the exact question that I wanted answered.

BY MR. ATTAWAY:

Q In Exhibit 14, you worked an industry-wide surcharge; right?

A Correct; 21-1/2 percent.

Q 21-1/2 percent.

A Right.

Q If you then take the example in Exhibit 16--

A [interposing] Which example?

Q The first sheet. The system that had $150,000 of gross revenues in '81.

A Right.

Q And multiply its DSE percentage, .01525, times the surcharge. To save a step multiply it by 1.2152, take that percentage of $150,000. That becomes its adjusted royalty rate.

A That's correct.

Q Times $150,000.

A Right.

Q What do you get?

A 2779.

Q That is what this system would pay--

A [interposing] On an average industry basis.

COMMISSIONER JAMES: May I stop you there. Going back to 14, wouldn't that system at $150,000 fill out a form two.

MR. ATTAWAY: That is correct. In this example, if there is an industry-wide adjustment, this system having the same number of subscribers, carrying the same number of DSEs would drop into a lower category.

COMMISSIONER JAMES: That figure that that system would pay is $2,000.

MR. ATTAWAY: It would pay much less than that because it pays the statutory percentage for small systems which you don't have the authority to adjust. They stay the same. So, they would be paying something less than one percent.

They would be paying .5 percent on the first $80,000 and one percent on the remainder.

MR. COOPER: $15 for the first $41,500 and pay the .8 on the balance between $41,500 and $150,000. That is the statute.

MR. ATTAWAY: They would not be paying on the DSE formula. They would be paying under the formula for small systems whatever that would be.

COMMISSIONER JAMES: What is the witness' answer? How much would this system pay under applying Exhibit 14?

THE WITNESS: Applying Exhibit 14 and assuming they pay on a form three basis, 2779.

COMMISSIONER JAMES: We know they don't pay on a form three. So, it would be less than that even.

THE WITNESS: It would be reduced on a form two basis whatever that statutory figure is.

BY MR. ATTAWAY:

Q Just for the sake of illustration, can we run through it one more time on a different example?

Take the system making the $270,000 for January to June, 1981. Now, applying your example 14 to that growth figure, would you work this calculation out and tell me exactly what that system would pay?

THE WITNESS: The adjusted DSE percentage is .018531 on an industry basis.

BY MR. ATTAWAY:

Q How did you arrive at that?

You took the industry adjustment from 14 times--

A [interposing] 21 percent more than the statutory figure.

Q Okay.

A That figure time the $270,000 revenue base. The answer would be $5,003.

Q That is what that system would pay if you used the industry-wide?

A Right.

Q Under an industry-wide basis, that system would pay more than under your formula.

A Yes. Obviously, the entire industry is faced with inflation and this example of the cable system actually keeps pace with inflation.

Q It has to pay a surcharge even though its rate kept up with inflation.

A Right.

Shall we go on?

Q Yes.

A To summarize the testimony, I would recommend that you use the CPI despite its faults because it is like democracy, it is better than any other system. To maintain a real constant dollar level, adjust the DSE schedule and not the dollar royalty amount, require individual adjustments for each cable system not an overall industry adjustment, use a simple worksheet that gets credit for subscriber rate increases against the increases in CPI which also solves the problems of systems that have reduced their rates, new systems that have no base subscriber rate and systems that have a free subscriber use of the basic service.

I also recommended that the CPI adjustment should be made every reporting period and not every five years. This prevents substantial royalty loss for copyright owners. It also prevents shocking cable systems by sudden jumps in royalty fees that they may not have planned for.

With respect to tiered services, we did not really discuss that but any tier services that include secondary transmissions, I understand that their revenues, I'm recommending that their revenues should be counted. I understand that their total DSEs are now supposed to be counted.

Q Mr. Korn, you will prepare this evening and make available to the Tribunal your calculations on the short fall and royalties if a semi-annual adjustment is not made until 1980, and, also, your calculations demonstrating the mathematics of the constant dollar formula that you are recommending; mathematical proof of its accuracy.

A Yes.

MR. ATTAWAY: That's all the questioning that we have, Madam Chairman.

MR. FELDSTEIN: Would you be planning to go straight across or break at some point?

CHAIRMAN BURG: I am proceeding on the assumption that your cross-examination will take your estimated, what you estimated yesterday of half an hour.

MR. FELDSTEIN: It is a quarter to noon. We could get into it if you would.

CHAIRMAN BURG: I am not going to limit you to the half hour. This seems a little early to conclude the morning session.

MR. FELDSTEIN: I would like to preliminarily raise one legal point; that is, in Exhibit 17, which is the summary of Mr. Korn's testimony, he states that, having not mentioned it at all in his testimony, he talks about tiered services and makes a couple of points about total revenues and DSEs. I would move that that testimony and those points be stricken for two reasons.

One is that this is clearly outside the purview of the provision under which the Tribunal is now conducting this proceeding.

Secondly, it may well be more appropriate for the copyright office and therefore, be totally outside the authority of the Copyright Royalty Tribunal.

MR. ATTAWAY: Madam Chairman. Mr. Korn did mention these points although briefly in his concluding statement.

As to the authority of the Tribunal, this proceeding is to permit the Tribunal to make adjustments for changes in charges and the rates charged to subscribers.

Tiering is an example of how cable systems are altering their charges to subscribers. I do think that this Tribunal has authority to review these changes.

It might be that the copyright office would or has already ruled on this issue. I think it is also before the Tribunal.

MR. FELDSTEIN: I think it is relevant that the Tribunal look at how these things are treated possibly in making their adjustments, but I do not believe it is within the purview of the Tribunal's authority as to how these matters should be treated by a cable system.

CHAIRMAN BURG: Mr. Feldstein, we will note your objection.

Mr. Feldstein, you may continue.

CROSS-EXAMINATION

BY MR. FELDSTEIN:

Q 'Mr. Korn, I want to direct your attention to your Exhibit 14 which contains your inflation figures and a one time adjustment, calculation. At the bottom where you talk about "New Borderlines for Smaller Cable Systems," you use a 15 percent rate increase in your example, 1.1515; is that correct?

A Yes.

Q Based on the data which was presented yesterday by Mr. Cooper--

A That is correct.

Q --in your methodology, on an individual system basis, would you be using that figure for each system or would you be using each individual system's rate increase as the measurer?

A Each individual system.

Q You would use each individual system.

A Each system would file its own rate figures. The worksheet would automatically use their own subscriber rate changes.

Q In that case, wouldn't the difference result for each system because they would have a rate increase history tend to put each system in different categories despite the fact that they might be the same size?

A By "size", you mean what?

Q If the system had 2500 subscribers and its rate went up 10 percent and another one's went up 18 percent and you multiply it out by your method, you could have someone in a form one category and someone in a form two or you could have someone in a form two and the other one might get bumped into a form three even though they are the same size.

A No. The category is not determined by the number of subscribers. It is by gross revenue.

Q That's right, but what if its gross revenues factored out to in excess of the statutory amount for that category?

A If its gross revenues changed.

Q Because of his rate increase.

A Then the borderline would change accordingly. He would still be in the same category.

Q The borderline would be different for each system.

A Exactly.

Q How do you pick the system size?

A Are you talking about gross revenues?

Q Number of subscribers.

A The borderline is set by gross revenues not by number of subscribers.

Q The borderline in the statutory is set by gross revenues; correct?

A What was that?

Q The borderline is set by $80,000 for example.

A The $80,000 will change for each system depending on how much it increased its rate. If the rates did not change at all, the $80,000 would be the same for that system.

If it increased its ratees, say, by 40 percent, then the $80,000 would go up by 40 percent.

Q How does it stay in that category? I mean where do you start from?

A I don't follow.

Q Are you taking 76 systems and just letting them move along with the category?

A No, they are moving along with their own change in subscriber rates.

Q So that a system---

A [interposing] So that a system would go out of another category by adding additional subscribers.

Q I thought we don't count the number of subscribers, just gross revenues.

A You wanted to know how?

Q So it is conceivable that someone could carry with the same number of subscribers he has today, to carry himself along as a form two or forever, with a massive amount of revenues. Whereas, another system with a much smaller amount of revenues is in a form two.

A Wait. No, that is not conceivable.

If you had a massive amount of revenues, he would be in a form three category.

Q From a rate increase.

A Remember it changes rate increase.

Q Yes.

A But there is a ceiling on that. If he changes his rate increase so he exceeded the inflation right--

Q He does not exceed.

A Then it is not massive.

Q How about a new system that comes into being. We have a system with 2,000 subscribers, continually is raising its rates and you now got him up instead of $80,000, his form one ceiling, is now $137,000. You carried him right along and he is still in form one.

A new system comes along instead of with these hugh rates with a $7 rate, he has got the same number of subscribers. He multiplies himself out own his gross revenues and he exceeds the $80,000 in the statute, which means he pays a higher rate; is that correct?

A I have not addressed myself to new systems as far as the rate levels are concerned.

Q In other words, systems of the same size. What you are saying then is systems of the same size depending on when they started and what their rates were might be in different categories, form categories?

A No, I said I didn't address that question as far as the borderline rates are concerned or borderline gross revenues are concerned.

Q . If you were to use a systemwide, an industrywide approach to the small cable systems, you would have to use, your interpretation the average, was not Mr. Cooper's rate data for DSEs paying systems.

A Yes, it was.

Q Therefore, this would be an improper average to use here since we are referring to smaller systems.

A I understood that the overall averages--

Q [interposing] You didn't testify to that nor did Mr. Cooper.

A Yes, he had several different averages.

Q Did Mr. Cooper's; the rates that he was relying on, the CRT survey--

A [interposing] I know his survey was only performed for form three systems.

What I was saying on that same exhibit there were other service which seemed to have consistent figures which included other than form three systems.

Q In this small system, system by system adjustment, some kind of a worksheet plus instructions plus the semi-annual adjustment would be needed to been sent to all systems I presume in the small category.

A No. The semi-annual rate adjustment is not necessarily for that. That would be published by the CRT.

Q Presumably a system, until he worked this out, would not know whether he was in form one, two or three; would he?

A That's correct.

Q Now, presently, the copyright office knows which form these people are in. If they change, they let them know. They mail them the proper form or do they mail them all three forms and say choose what is proper for you?

A I don't know. On the present form, there is a sentence that says if you don't hit this figure, go to the other form.

Q They would have to recalculate that each time.

A They would handle it the same way as presently. When they find they are in the wrong bracket, the instructions refers them to the other form.

Q On top of the same page of Exhibit 14, where you have your inflation information, you use April, 1980. Why have you choose April, 1980?

A I chose April, 1980, because it is the middle of a six-month period and it was the lastest six-month period for which we had figures available.

The CRT questionnaire had the corresponding cable rates available, and I figured I would use those inspite of the fact they are only form three systems since it was the lastest available information.

Q Didn't the CRT survey asked people what rates were in April 1, 1980?

A I am not sure, if you say so.

Q If that is so, wouldn't the more proper end measure have been, it is not the CPI, published once a month?

A The CPI is published once a month and is supposed to represent the entire month.

Q Therefore, would not the more appropriate measure, end measure, not be April, 1980, but March, 1980?

A It is a toss up between March of 1980 and April. The reason I chose April, frankly, was that the CPI sometimes has a two-month lag. Part of the price data is collected monthly and part of it is collected bi-monthly.

Q You stated that your system by system approach applies to what might happen in 1980-1985 which is interesting in light of the Tribunal's looking at '76 to '80 with all this other data.

In your approach, therefore, you admitted, theoretically, is it not, you stated that in your testimony.

A Exactly what are you referring to. I am not sure. You say my approach to what?

Q You stated that your system by system approach that you went through on your worksheets was based on theoretical assumptions.

A Yes.

Q Is there any data to support what will happen between 1980 and 1985?

A You mean the assumptions to 1. 50--

Q [interposing] No. As to what systems might do.

A This is not to represent what systems might do. This is an example of a particular system, and I took the example, selected the example, so data would be consistent for the four different examples.

Q Do you believe that the Tribunal should be put in the position of estimating or guessing as to what the developments might be in the next five years?

A No. I think that they should design their procedures so that, as best they can, take into account whatever might happen. Yes.

Q You have shown a great solicitousness for the fairness of your system by system approach of cable television systems. Doesn't the 1976 Act apply to same royalty rates to otherwise identically placed cable systems who have differing basic subscriber rates?

A I am sorry. I did not understand. You said I was solicitous abou the cable systems--

Q [interposing] Your approach and you stated is supposed to be fairer than the cable system plan. I am asking you under the 1976 Act approach, the approach that is, the law and is applied right now and has been done on all the forms which have been filed thus far--

A [interposing] You are confusing me. Can you tell me or are you talking about the gross revenue limits or what?

Q No. I'm talking about the application of the percentages.

A Then I wasn't solicitious of the cable systems about that.

Q I am not asking you that. I am asking about the 1976 Act as it is applied to the cable industry, does it not apply the same percentage rates whether on a DSE basis, well, on the DSE basis, does it not apply the same rates to systems no matter what their monthly subscribers fees are?

A Well, the same rates, but it does not give you the same results because subscriber fees are reflected in the revenues. So, therefore,--

Q My point is if a system with 5,000 subscribers in three DSEs, one charged $6 for a basic rate and one charged

A Yes.

Q That's based on the average-- May I hear your answer; yes or no.

A Yes.

Q This approach is part of an individualized system approach; is that correct?

A Yes.

Q Are you recommending imposing an industry average for post-1976 systems on an individualized approach?

A Do you want me to answer that now?

Q Yes.

A For those systems that went into operation after 1976 and who also have a zero base at present, which is the ones you are asking me about, it does not matter what figure you put in there, whether $6.60 or anything because they are getting the full effect of inflation.

The only affect would be, on an average basis, of giving them the revenue base of the average.

Q All I am asking you is whether you have used an average, an industry average, imposed on an individual system approach.

A For those systems that went into effect after '76, yes.

Q For those systems since you assume in October, 1976, date and an October, 1976, rate, and then move to an April, 1981, date, aren't you imposing a full four years of inflation on such systems even though they may have begun operation anytime up until the beginning of 1980?

A I am not imposing the inflation. The real constant

$9 for a basic rate, the person who is paying on his copyright royalty fees on the $9 rate pays more copyright royalty fees than the person who has the $6 basic rate; is that correct?

A The system that has the $9 royalty rate.

Q The $9 basic rate.

A --basic rate, pays a higher fee than the one who pays the $6.

Q Is that correct?

A Sure.

Q In other words, the rates established in the 1976 Act, royalty rates, were based on average basic subscriber rates; is that not true?

A The royalty rates are percentages.

Q Based on-- Since the Congress was attempting to raise a particular amount of money, where they not, establishing those royalty rates to be applied against basic subscriber rates, gross revenues, if you will, in the full knowledge that different subscriber rates were charged by different systems?

A Yes.

MR. ATTAWAY: Madam Chairman, I have to object to the statement that Congress was trying to raise a particular amount of money. I don't think that has been established in this testimony. I don't think it is true.

BY MR. FELDSTEIN:

Q You have alluded to the statute today.

CHAIRMAN BURG: Are you talking in response to his objection?

MR. FELDSTEIN: The witness recommended an individualized calculation . I'm trying to establish the fact that no individualized approach existed or exists under the '76 Act.

COMMISSION BRENNAN: The objection goes to the foundation to your statement that Congress was seeking to raise a particular sum of money. That has not been established in this record.

MR. ATTAWAY: If it will help, counsel for NCTA, I will stipulate that the statutory rates apply equally to all systems no matter what they charge.

MR. FELDSTEIN: Thank you.

BY MR. FELDSTEIN:

Q You have quoted and read from the provision under which the DSE system adjustment is to be, under which this adjustment is to be made, 801(b)2A.

In one of your worksheets, you alluded to the fact that the system might, by lowering its rates, drop its gross revenues below the limitations provided for in the statute for short forms and thereby move from form three into a lower category.

A Under my system, the borderline would lower in proportion and they would not be able to do that under my worksheets.

Q For post-1976 systems, that is systems who go into operation prior to October, 1976, that is, new systems-- I am sorry. Correct that. I meant systems who went into operation after October, 1976, the new systems, there was no rate for subscriber rate, they gave basic away, you have made a $6.60 assumption in terms of 1976 rates; correct?

value of the dollar is that in 1981, it is CPI that determines what kind of dollars they pay in. It is not determined by what time they go into business.

Q Why should earlier years inflation be imposed on a system that began operation December, 1979?

A I look at it as them paying the royalty fee in the constant dollar equivalent to what it was in 1976. That is what the act says. It does not make a specific case of new systems.

Q There are often marketplace factors as to why rates are set at a particular level. Let's assume a CATV operator who began operation prior to 1976, and set his rates at $4 and by 1980, his rates are now $6. Under your assumption, under your work sheets, since he had a 50 percent increase in his basic rates, he has no surcharge; is that correct?

A It is not just my assumption. The act itself says that.

Q The fellow comes along who has the same kind of system in the same kind of city and for the same marketplace reasons put his basic fee at less than, say, an average rate and has no rate increase to show because he just began an operation, he is going to have a large inflation surcharge is he not?

A Is this a new system?

Q Yes.

A That starts and has a lower rate, less than average rate.

Q Yes.

A But had no subscriber rate in 1976?

Q Correct.

A You measured from industry average in '76 to what he has now. He would have a surcharge on that. Yes.

Q These two systems might conceivably have the same rate now but one has a surcharge and one does not.

A That's your example.

MR. FELDSTEIN: Why don't we break and resume at 2:00 o'clock.

[Whereupon, at 12:15 p.m., a lunch break was taken to resume at 2:00 o'clock, p.m.]

\- - -

AFTERNOON SESSION

CHAIRMAN BURG: We are on the record.

Mr. FELDSTEIN, You may proceed.

MR. FELDSTEIN: Thank you.

CROSS-EXAMINATION (Continued)

BY MR. FELDSTEIN:

Q Mr. Korn, you have recommended that each cable system should adjust its copyright royalty payment for inflation individually in each six-month reporting period.

A Right.

Q Assuming that inflation exceeded basic rate increases, this would produce an increase in an individual cable systems copyright cost; is that correct?

A If it has the same revenue base, yes.

Q If the cable operator wanted to be able to recover this increased cost, and he was a rate regulated system, he would have to frequently enter into the arena of asking for rate increases from his regulatory body; is that correct?

A Well, I assume that the question of whether he wants a rate increase would consider a lot more things than the growth of the small amount of penalty has on royalty fees. It is a merchandising decision. Of course, one item would be the cost of the signals. Right.

Q Your approach, would it not, deny the cable operator, cable industry, the opportunity for a hearing before the CRT demonstrate the effects of regulatory restraint and/or other extenuating factors both which are, seemingly, provided for in the Act?

A On the contrary, I think unless you handle it on an individual basis, you can't really get at those questions.

In other words, if an individual system is claiming some extenuating circumstance, I don't see how you would get at it if he has to file on an average basis.

Q Are you then saying that there would be an individual hearing for a system which had a problem before this Tribunal?

A I don't know how it would be handled legally but certainly if there are extenuating circumstances that are not general to the industry and I don't see any general such circumstances, they would have to be taken up individually. I just don't know what the method would be of doing it.

Q With 1,050 DSE paying systems and this adjustment every six months, you would envision some kind of ad hoc mechanism for each system.

A I don't envision really much activity in that area. It appears that the extenuating circumstances that the Act had in mind apparently did not occur from what I heard yesterday. The Congress is apparently afraid that some system is going to be squeezed by its own franchise city or something and did not want the CRT to give it the last push, but obviously since that time with the movie channels and the additional channels, pay channels, those circumstances don't exist. So, I see very little use for that.

Q Mr. Korn, do you believe that every system has those kinds of channels on it?

A I think most of them do and within a few years, they all will.

Q Are you saying if a particular system had a regulatory restraint problem that that individual system and any other individual system so situated would have to come in possibly on a semi-annual basis to demonstrate its problem to the Tribunal?

A Yes.

Q Mr. Korn, under the current scheme in place and operating at the present time, if the Copyright Office wants to monitor or check correctness of the calculations, it need only look at a system's basic gross revenues, the number of DSEs and see whether the calculation is made correctly; is that correct?

A Yes.

Q Under your proposal and assuming that the Copyright Office wanted to supervise cable copyright payments as the forms came in and they checked them over, would it not also have to make separate individual determinations as to the basic rates in '76, the rates now, inflation over the same period as well as the number of DSEs carried and the basic revenues received?

A Well, the inflation rate, of course, is given to everybody. That is the same for everybody. The number of DSEs scheduled that would have to be checked in either case under either system. Rather than substituting for revenues, you are substituting for cable rates.

I feel that the cable rates are more able to be obtained. If copyright decides to do all the checking, perhaps the copyright owner could do checking by comparing the cable rates shown there with the fact book or whatever.

Q The fact book is annual. Wouldn't they also have to know the basic rate at the beginning and end of the semiannual period?

A I'm sorry. Who would have to know?

Q The Copyright Office.

A Yes.

Q They would have to know the basic rate.

A The Copyright Office would have it because it would be submitted by the cable company. Yes.

Q Wouldn't they have an extra set of calculations to check, the several calculations which are included in your worksheet?

A Yes, but they can be simplified. I prepared the worksheet to be in logical order, but there is another formula that will do it on a calculator at no time at all.

Q Would this conceivably not have to be done for all of the thousand fifty in the DSE category?

A If someone wanted to check the arithmetic, it could be done. I don't know that they are now. If they are, the same amount will work.

Q In your calculations in your worksheets, you spoke of whether the basic rate; that is to say, are you referring this to the basic monthly charge that a cable system imposes on a subscriber?

A That's what I would use. That is what I would read the provisions of the Act as saying.

Q Have you included in that revenues which might, other revenues, which might be obtained for retransmission from a subscriber such as connections to additional sets?

A Section 801 speaks about Subscriber Rates and it seems to me it uses it as a proxy for average revenue per subscriber. It probably would be better to use average revenue per subscriber to make it work perfectly, but in view of the fact that Section 801, more or less, directs the use of subscriber rates as a proxy not too much is loss because my understanding is that the other charges are usually proportional to the basic charge in any case.

So, let's say they were 10 percent higher. It would not make any difference whether they used the figure that's 10 percent higher in 1976 and 1980.

Q Would it make a difference if more homes took an additional set?

A No, because you are a per subscriber basis here; proportionally more, yes; not more homes.

MR. FELDSTEIN: That concludes cross-examination.

CHAIRMAN BURG: Thank you, Mr. Korn.

MR. ATTAWAY: I have redirect.

CHAIRMAN BURG: All right.

REDIRECT EXAMINATION

BY MR. ATTAWAY:

Q Mr. Korn, during the luncheon break, I understand you made some calculations to further answer the questions of Commissioner James. Unfortunately, Commissioner James is not present, but for the benefit of the other members of the Tribunal, you might demonstrate to them the actual difference between the industry-wide adjustment and the cable system by cable system adjustment using the hypothetical cable systems that you used in your worksheets that you handed out earlier.

A These are the same worksheets except that I filled them out during the lunch time. The same ones you have with extra scribble on it to show what the overall industry average would be.

Of course, this worksheet was prepared originally to represent a period of, the first period of 1981. The Exhibit No. 14 was for a period, first period in 1980. So, they are different periods, and, therefore, the increase that we got in Exhibit No. 14 of 21-1/2 percent surcharge for inflation, the net industry figure, is for a different period, but assuming that the same ratio applies for the latter period, I have calculated on these worksheets what were the actual royalty fee being under those assumptions.

Looking at the first sheet, the first change is made down in line "B", the bottom of the page. The $160,000 limit, instead of being multiplied by line four above is now multiplied by the industry, the average, which is one point to 152. I've done the arithmetic. It is $192,432. Therefore, this system which only had 150,000 gross is considered to be a smaller system. If a smaller system would pay on the following basis, if you will note the scribbling, the $80,000 limit now becomes 97216 by multiplying by the same factor.

The statute requires us to pay half of one percent of that which is $486, and for the amount over that which is 52784, one percent of that which is $528 for a total fee of a $1,014.

So, this system under the assumption we've made would now pay, not as a schedule three system any more, but would pay a total of $1,014 instead of the $4,117.

On the next page, I've done the same thing for a system that did not increase at all in its rates. Going down to line "B", again, it is the same calculations. Actually it is the same fee because this system is only 180,000 below the 194,000 new industry limit. So, therefore, this system would now pay based on this revenue $486,000 for the first 47216 and 828,000 at one percent for the balance for a total of 1,314 dollars compared to the 4117.

On the next page, I have not shown line "B" because the 270 is over the 194,000. This system has to pay on the DSE schedules.

Now, what does it pay?

If you go down to line "D", instead of none, it would pay the industry average of .2152 which is .003 points more on the royalty rate for total royalty rate of .01853. When you multiply that by the 270,000, you get $5,003 compared to the original sheet which showed 4117.

Finall y , on the last example where this system actually increases rates from $6 to $8 and kept pace with inflation, I have not shown on line "B", the 194,000 again because the $240,000, obviously, exceeds it, but when you get down to the surcharge, again, we use the industry average surcharge of .2152 which adds .0033 to the royalty rate schedule for a total of .01853 and applying that royalty rate to the $240,000, you get 4447 compared to the 4117.

COMMISSIONER GARCIA: On example one and two, you multiply it by 1.2152.

THE WITNESS: Which is the industry average, yes.

COMMISSIONER GARCIA: We wouldn't multiply that by 1.15 and bring in--

THE WITNESS: No. If you recall on Exhibit 14, 1.1515 is the cable rate increase.

BY MR. ATTAWAY:

Q You would multiply by .15.

A It is the case increase we are talking about. I withdraw everything I said on this. We have to recalculate it.

COMMISSIONER GARCIA: If calculated, it becomes 184. The theory would be the same.

THE WITNESS: Right. It would not affect it because they still exceed the limits. On the other two sheets, it doesn't apply because they are over.

CHAIRMAN BURG: Mr. Korn, yesterday, Mr. Attaway made a representation of a 20 percent surcharge. I asked Mr. Valenti about that 20 percent surcharge. He said he was not the proper person to ask. Seeing that you are the last witness, what happened to that 20 percent?

THE WITNESS: That's the .2152, 2152 percent industry average surcharge.

CHAIRMAN BURG: But do you have to go through all of this to accomplish that?

THE WITNESS: No, not on an industry average. It is all done on Exhibit 14, the net surcharge. In other words, the inflation minus the cable rate increase adjusted for 1980 base instead of '76 base gives you 21 percent. That I believe is what he was referring to.

CHAIRMAN BURG: Instead of 20. I understand.

THE WITNESS: If you want to do it that way, everybody pay 21 percent more or whatever it would be when you look at it again. This is based on April, 1980.

CHAIRMAN BURG: Which would do away with the necessity of all of this, all of these computations.

THE WITNESS: These computations are made by each cable system, just one of them not all of them. We showed you samples of each one to show that it comes out to the answer which is consistent with the Act holding the royalty fee per subscriber constant.

The cable system would have to fill out the information on here, not necessarily on this form but on a revised form three.

CHAIRMAN BURG: Okay.

COMMISSIONER GARCIA: I am confused on one issue still. The revenues from the tiers, the examples that you gave us cable by cable would cover those.

THE WITNESS: I didn't hear the first part.

COMMISSIONER GARCIA: The tiers.

THE WITNESS: The tiering problem is, first, that revenues may be reduced. One of these shows revenues reduced.

The other tiering problem is that a new system may come on with zero or free service in the basic service chart.

COMMISSIONER GARCIA: I guess, Mr. Korn, my question is only if we do it system by system will we be able to take care of the tier. If we do, one, adjust, let us say, what your recommended 20 percent for the whole cable industry, we still have lost the tiers that are now falling through the crack.

THE WITNESS: Yes. I am not recommending the 20 percent across the board.

COMMISSIONER GARCIA: I understand that.

THE WITNESS: Not only are the tiers lost but some of the other factors we mentioned are lost. How do you treat systems that went up higher than inflation?

How do you treat systems that didn't go up at all or went down and therefore are getting the benefit of a low base to apply to percentage against the expense of the other systems because they are not average.

BY MR. ATTAWAY:

Q Mr. Korn, counsel for NCTA was concerned about the effect of your proposal on systems that came in to being since 1976 and how the small system ceiling would be applied to them.

As I understand your proposal, for a system in being in 1976, you would take their actual '76 rate and compare it to the actual 1980 rate and multiply the ceiling number, the 80 and the 160 times the percentage increase in the cable systems' individual rates over that period of time.

A That's correct.

Q If the system was charging the industry average in 1976 of $6.60 or whatever it might be and increased it to $8 which would be a 21.2 percent increase, the ceiling, small systems' ceiling, for that system would be increased by 21.2 percent.

A I don't know if-- I think it is a 33 percent increase.

Q I am not very good with the calculator but the same percentage.

A Whatever that increase would be, it would increase the ceiling to that.

Q Take a system that did not exist in '76 and you have assigned a constructed '76 subscriber rate to them; right?

A Yes.

Q Which would be the industry average in '76? If the industry average was $6.60 in '76 and the new system that just came into being this year is charging $8, you would again multiply the small system by that percentage of increase.

A That's correct. In other words, the new system would be treated exactly the same as the old system except we have a proxy 1976 base rate which would be the industry average.

Before when I said I did not address that problem, I guess I really forgot how to handle it. The form does address it by using a substitute value for '76 for a new system which is the average industry value.

So, no matter what it is at present, you measure from the average industry base and that increase is then applied to the $160,000 or revenue.

Q Counsel for NCTA was also concerned about the fact that the statute applies the same royalty rates of .675 and .425, et cetera, to all systems regardless of their particular basic subscriber rate structure. I stipulate that that was the case. It does not take that into account.

Under your formula, differences in the charge for basic subscribers would be taken into account; is that correct?

A Yes.

Q Isn't that indeed the very purpose of this proceeding according to the statute to take those changes into account?

A As well as the inflation change, yes.

Q Finally, counsel for NCTA was concerned about the imposition of past inflation upon new systems. I wasn't born yesterday but had I been, would not the past inflation affect the prices I pay for goods and services today?

A Yes.

Q It would for new cable systems as well; right?

A Yes, I think the statute applies to new cable systems. They want to keep the fees constant with the '76 dollar.

MR. ATTAWAY: Thank you.

MR. FELDSTEIN: Madam Chairman, can these worksheets which Mr. Attaway and Mr. Korn have passed out, I wonder if they could be marked for some kind of exhibit number if they are referred to at some point?

MR. ATTAWAY: It would make it Exhibit 18. Let the record show, however, that there is a error in the calculations for the small system ceiling.

THE WITNESS: I can tell you what it should be. Instead of 1.2152 on line "B"--

CHAIRMAN BURG: [interposing] Which page?

THE WITNESS: On the first sheet, line "B", instead of 1.215, the correct figure should be 1.1515 and instead of the result being $194,000, the correct result is $184,240. The same two corrections apply to the next sheet. That's it.

BY MR. ATTAWAY:

Q Wouldn't you have to correct also the $180,000?

A Yes. I would have to correct the $180,000 figure. Instead of 1.2152 there, it again should be 1.1515 and the 97216 becomes 92120 and the 486 becomes 461.

CHAIRMAN BURG: Mr. Attaway, could Mr. Korn submit some clean copies?

MR. ATTAWAY: Yes.

CHAIRMAN BURG: That would be saving time now.

MR. FELDSTEIN: Marked as Exhibit 18?

CHAIRMAN BURG: Correct.

MR. ATTAWAY: Mr. Feldstein asked that some material be inserted into the record. I have that now to introduce it or I can wait until later. It is the Warburg Paribas Becker Report and the Variety Analysis of Prime Time Production Cost. This will become Exhibit 19 and 20.

[Whereupon, the document referred to were marked for identification and received in evidence as Exhibit Nos. 18, 19 and 20, respectively.]

COMMISSIONER GARCIA: Which is 19 and which is 20?

MR. ATTAWAY: The Warburg Paribas Becker will become 19 and the Variety 20.

Madam Chairman, that concludes the direct case of Copyright owners. I had intended to make a closing statement, however, in light of the fact that our case has taken more time than we advised the Tribunal it would take, as well as opposing counsel, I think that the points that we have made are clear to the Tribunal. I hope they are. I will close without further argument.

CHAIRMAN BURG: Thank you. Mr. Garrett.

MR. GARRETT: Madam Chairman, for the record, my name is Bob Garrett of the law firm Arnold and Porter here representing major league baseball specifically but I believe I speak for other professional sports leagues that are party to this proceeding.

We have agreed with the other Copyright owners that the interest of the expedited and orderly presentation of brief,it would be in the best interest to allow Mr. Attaway and MPAA to take a lead in the case which he has done very ably. We have not sought, therefore, to introduce our own witnesses nor introduce other own testimony.

Nevertheless, I want to make it clear we have worked closely with MPAA in its prosecution of the case and we strongly support all the proposals of the Copyright Owners.

I would like to emphasize one aspect of the owners if I could. The NCTA and the cable industry has suggested that the Tribunal should adjust the rates essentially on a catch up basis.

Specifically that if they adjust them at all, if the Tribunal adjust the rates at all, it should be on one time and not changing again until 1985.

The Copyright Owners, on the other hand, have urged that the Tribunal adjust the rates so the cable system for each semi-annual accounting period pays a royalty which reflects the change in inflation as well as that system's change in rates.

As Mr. Korn has testified, the difference between the two proposals is considerable. The amount of royalties that we stand to lose over the next five years when one plays the catch up adjustment games that NCTA suggests would be in the neighborhood of several million dollars.

I would like to just answer, if I could, also, Madam Chairman, a question you raised earlier. I don't believe that the proposal that the Copyright Owners have submitted here would result or obviate the need for a review in 1985. I think that the record will very clearly demonstrate, for example, that there is to be no changes in their rate adjusted here as a result of any kind of effect that the franchise authorities would have on raising rates.

I believe, however, that in 1985 the cable industry can come in and say there has been an effect and that is a factor you can taken into account as to a change in future years. There is still plenty of work that can be done in 1985. I don't believe that the record before you here that there would be a need for that kind of adjustment. I guess with that, unless there are any questions, the balance of my 12 percent of my time will be spent here.

CHAIRMAN BURG: Thank you.

Questions. If not, we will proceed to your direct case Mr. Feldstein.

MR. FELDSTEIN: Thank you.

My apology to the rear of the room for not being able to see these charts as they are presented.

I would like these marked as NCTA exhibits. Notice there is 3-A and 3-B. It runs essentially 1 through 12. They are marked as such not on these charts but on the soft copies. You will notice that you do not have number 13. That one will be handed out later. This runs through 12. The list on the front is not an exhibit. It is merely a table of contents for reference.

The provisions under which we are working are

Section 801(B)2A and D of the Copyright Act. As has been pointed out to you in previous testimony, the goal is to maintain the real constant dollar level of the royalty fee per subscriber as of the date of enactment of this Act.

The statute states that this Tribunal authority is to make determinations concerning the adjustment of the Copyright Royalty rates in Section 111 solely in accordance with the following provisions.

It is also made clear in the House report on page 175 where it again tracks the language and states solely in accordance with the following provisions.

The following provisions in Section 801 and subsequent sections states that an adjustment of the royalty rates found in Section 111 shall be made every five years. Likewise, an adjustment of the gross receipts limitation for smaller systems shall be made every five years.

This is reiterated in the Conference Report where it states that the copyright, at page 76, excuse me, it states that the Copyright Royalty, then called commission, would review the rates established in the bill in 1980 and at five year intervals thereafter. Explicit limitations were placed on the factors the Commission could consider in making its periodic rate revisions.

Thus, it is our interpretation--not our interpretation--we believe that the statute quite clearly states that the royalty rates shall be adjusted, that this adjustment shall be every five years, not that a mechanism shall be placed into effect which will automatically adjust the rates every six months. Congress could have done that. This is what

Congress did.

Secondly, the 1976 scheme applies to royalty rates as well as the gross receipts limitations on an average basis over the entire industry. Each system uses the same rates. Each system uses the same gross receipts limitations. The statute is based on averages. It is like the income tax code or any other of a number of statutes. It does not permit, it is not without the four walls of this statute, it is not solely in accordance with this statute to make adjustments on an individualized system basis. Thus, in the case of DES systems having 1,050 different royalty rates.

Thus, the issues between us and the copyright owners are clear. An adjustment every five years pursuant to statute or a mechanism for adjustments every six months. An adjustment to the industry as a whole as provided in the 1976 statute or an adjustment based on an individualized system basis.

Now, moving on, the language of the statute, again, to repeat this states that what is to be maintained is the real constant dollar level of the royalty fee per subscriber. That does not say per program. It does not say per signal. It states royalty fee per subscriber. How many dollars were obtained per subscriber as of the date of enactment of this Act, October 19, 1976?

How many dollars are obtained from a subscriber now and has that increase, if there has been an increase, kept up with inflation considering all of the other factors which might come into play?

There is also explained at page 175 of the House the rise in the royalty fee per subscriber and inflation, we will also demonstrate that regulatory restraint is real and has pervaded a substantial portion of this industry and has had both a restraining effect on the amount of rate increases as well as a considerable delay in obtaining rate increases of whatever size, and that the Tribunal should take into account the substanital regulatory restraint in making its final decisions as the Act provides.

As for the smaller system adjustment which calls for the gross receipts limitations to be adjusted rather than the rates the copyright is figured on, this states it shall be adjusted to reflect national monetary inflation or deflation or changes in the average rates charged cable system subscribers for the basic service in order to maintain the real constant dollar value of the exemption provided by such section.

The operative words to maintain the real constant dollar value of the exemption. It is our contention that if inflation exceeds the rate increases which these systems were able to obtain between 1976 and 1980, then the dollar limitation must be adjusted to the limits of inflation.

Both of these considerations, again, are for the industry as a whole which we believe is what the Act specifically provides for.

I would like to call my first witness.

CHAIRMAN BURG: All right.

MR. FELDSTEIN: Robert Crandall.

Whereupon,

ROBERT CRANDALL,

was called as a witness, and having been duly sworn, was examined and testified as follows:

MR. FELDSTEIN: Before Mr. Crandall, begins his testimony, let me alert the Tribunal and Mr. Attaway that Mr. Crandall has an important previously made engagement which he must meet at 4:00 o'clock. If we are finished with him in terms of direct and cross, fine, but I would ask your indulgence if there is a conflict until tomorrow with Mr. Crandall to accommodate him.

CHAIRMAN BURG: All right.

DIRECT EXAMINATION

BY MR. FELDSTEIN:

Q Would you please state your name and occupation?

A My name is Robert Crandall. I'm an economist, senior fellow at the Brookings Institute.

My background and qualifications are that I have a Ph.D in Economics from Northwestern University. I have taught for eight years on the economics faculty at the Massachusetts Institute of Technology. Since that time, 1974, I spent one year as advisor to Glen Robertson, Commissioner in the Federal Communications Commission and two and one half years in the Council of Price and Wage Stability as assistant director, acting director and deputy director leaving in January of 1978 to assume my present position.

Q Mr. Crandall, you see we have put up a chart which you will find in your soft list there as Exhibit 2. Can you explain the chart to the Tribunal?

A This is a chart prepared under my direction of the alternative measures of inflation. Since this proceeding deals with attempts to maintain the real constant dollar value of some flow of income, the question arises as to which is the appropriate deflator to deflat nominal dollar flows so as to render them comparable over a period of time of general inflation.

The measures are here are but a few of those available. The problem of determining the ideal index number is a problem that has been with us for a very long time, in fact, eludes a satisfactory solution. There is no ideal index. Some are better than others.

The most commonly used general index is the consumer price index which is the CPIU. This is introduced monthly by the Bureau of Labor Statistics.

The column next to it on the right is the consumer price index less mortgage interest rates to show how much since October, '76, mortgage interest rates have contributed to the increase in the consumer price index.

To the left of the consumer price index-- By the way, both of these the CPIU and its subcomponents, the mortgage interest rates, are not seasonally adjusted. One could often include the seasonally adjusted numbers. For most purposes, the seasonally adjusted number is probably a better choice.

The problem when you get into mortgage interest rate is that the interest rates usually have not followed any any well-worn seasonal track. We have had two very serious credit crunches announced by the Federal Reserve not at all related to seasons; one was in October of last year and one

21

in March of this year.

The remaining columns on this chart are deflators used by the Office of Business Economics, now called the Bureau of Economics Analysis, at the Department of Commerce to deflate various components of our gross national product in order to make comparisons over a period of time of the value of GNP and the subcomponents.

The most general one is the GNP deflator in the far right. That is supposed to deflate everything in the gross national product including the government for which there is no good deflator. The only thing you can have in there is a measurer of the progress of wages and salaries in the government sector since there is no measurement of government output for example.

In subcategory, Private Product Business Deflator, includes all the private business in the United States. It excludes government but other than that, it has all the rest of the economy. You see its progress has been virtually identical to GNP.

The far left is the PCE deflator which is the Personal Consumption expenditures deflator which the Bureau of Economic Analysis usually deflates annual flows of consumption expeditures for all consumers. You will note that that index has moved less rapidly than the consumer price index over a period of time.

By the way, that estimate of October to March for that index is an estimate based upon an interpolation between the third and fourth quarters of 1976. It was back in 1976, they did not publish a monthly index. They now publish it monthly. So, I simply interpolated it linearly between those two quarters to get an estimated value for October.

The rate of increase in these two is smaller than the rate of increase in the PCE deflator since these are quarters rather than October to March. So, they are somewhat smaller because they are obviously centered in December and February rather than October and March.

Of these measurers, the question arises what would be the best choice of an index. It all depends on what you think you are deflating. If you interpret the fact sheet to mean you are deflating the flows of payments to individuals to consumers, you want a consumption index.

If the real constant value of copyright payments to a variety of owners of copyright rights are to be seen as payments to those individuals for their own private consumption, clearly you want consumption. Then the question arises which consumption measurer.

Over a very long period of time, it wouldn't make a lot of difference. If you were to go back 30 or 40 years, and we were during this over a very long period of time, the PCE and CPI have tended to move pretty much the same way. The reason is that the PCE is comprised of individual categories drawn from the CPI enumeration of the price of individual indexes.

However, in recent years, they have begun to divert because of the ways the CPI is measured and specifically because of the housing components. The housing component in the CPI can be described but its basis cannot be understood by anyone. It is simply an arbitrary calculation. The calculation, perhaps, which has been explained before but I can go over it briefl y. It is simply a measure which takes the home purchase price for all new houses purchased subject to FHA guaranteed loans, and, therefore, the lower segment of the houses purchased and adds to it one half of all of the future financing costs implicit in the mortgage agreement, so that if an individual, for instance, commits himself to buying a $70,000 and to paying over a 30-year period, something like $250,000 worth of interest payments, $125,000 of those will be added to the 70 and that becomes the basis for the housing index.

In fact, if the consumer price index were the cost of living index, that, of course, would suggest that there is a tremendous error in measuring the cost of living for most consumers. That isn't even a very good way to measure the cost of living for those people who buy FHA guaranteed houses.

Certainly it is not a way of measuring what has happened to the cost of living for other people particularly those people who have more mortgage than those who purchased their hourses in previous years.

You can see a divergence here between the CPI and the CPI less mortgage interest rates which was peaking about April or May of this year because the credit crunch hit in March. The mortgage interest rates began turning in April or May. In fact, the peak in the index was probably not March or April but 60 days after that since it only enters the index after closing, not at the time of initiation of the mortgage agreement. You have a mean lag which varies depending upon the cycle but say about 60 days.

So, we had an artificial increase due to the mortgage interest rate component as interest rates were soaring through, perhaps, June or July of this year. Since then, we have had a sharp decline in this part of the CPI. That, as a matter of fact, the index for the month of July showed, I believe, a zero increase because of the sharp decline in mortgage increase rates, according to the housing industry, offset the other inflationary increases in the economy. That effect continued in August. It will continue in a very minor way in September and will be back on the upward track again.

What this means is if you terminate any calculation of the cost of living in March or April of this year, you have an artificial bias introduced by the way in which the CPI is constructed.

Now, there are other problems with the deflators but that is the biggest single problem. The Bureau of Labor Statistics understands the problem. As a matter of fact, Jeanette Norwood served with me on a committee under the Ford Administration to deal with that problem. We finally sometime in '76 threw up our hands for a variety of technical and political reasons and decided not to do anything about it.

Since that time, the Bureau of Labor Statistics has begun to publish alternative indexes of home ownership costs but has not made a decision to incorporate any of them into the CPI.

The other problems with the CPI and therefore carried over into the PCE deflator are that they overstate inflation because of a failure to address a changing and improving quality of consumer goods. This can be a very important upward bias as shown by a recent study by Robert Gordon of Northwestern University in a study for the National Bureau of Economic Research.

The other major difference between the CPI and PCE deflator is that the CPI is a fixed weight deflator. This means that regardless of the change in relative prices, consumers are assumed to keep the same consumption bundle over time until periodically, every ten years or so, the fix rates are adjusted. The most recent adjustment was in the early 1970s; 1972-1973.

The PCE deflator as it appears on this board is the so-called implicit PCE deflator which has current period weight. There is also produced by the Bureau of Economic Analysis a fixed rate deflator if you wish to use that one.

It is well known among economists that a fixed rate deflator overstates inflation and a current weight deflator understates it. There is no ideal measure between the two of them. It would be something in between, but that source of bias is relatively small one, probably amounting, over the period in question, less than half a percentage point per year.

Whereas, the treatment of home ownership is much much larger. It would seem by far the better deflator to use for deflating consumption is the PCE deflator. Indeed the decision which has been made a long time ago by the Bureau of Economic Analysis at the Department of Commerce, and while it is not an ideal deflator and while it still has some problems because of the difficulty in treating weights and the difficulty in treating product quality, its housing component is probably a better component in that it attempts to expedite--

CHAIRMAN BURG: Mr. Crandall,would you slow your pace down please.

THE WITNESS: Yes. It attempts to estimate the inflicted rental cost of owning a house and uses status quos for all houses rather than simply focusing on new houses. So, I would suggest to you that the PCE deflator is by far the better deflator for the budget consumption expeditures over time particularly any time period in the early 1980s.

BY MR. FELDSTEIN:

Q Mr. Crandall,what you are therefore saying to this Tribunal is attempting to utilize the most accurate publicly available measurer of inflation, if we use a national consumption index that the CPI's deficiencies are such that the PCE would be a more accurate and better measurer?

A Yes.

Q There have been--let me clarify some of these points by stating some of the, repeating back to you some of the, things that were stated in favor of the CPI and against the PCE by Mr. Korn yesterday.

Mr. Korn said that the CPI was better because it includes only urban consumers whereas the PCE is not better because it also includes rural consumers.

A I suppose if copyright owners are supposed to live only in urban areas, there might be some validity to that but I would presume that you would want a national measurer. If you want a national measurer for all consumptions the PCE would be the better choice.

Q Mr. Korn stated that the PCE had a fault because it includes non-profit institutions. Would you comment on that?

A The PCE has nothing to do with profit or non-profit. The PCE is a measurer of the cost of a changing bundle of consumer expeditures. Some of these consumers may work for non-profit institutions but we don't use them out of the universe of consumers for that reason.

Q In comparing the CPI with the PCE, Mr. Korn said that because you had a fixed market basket in the CPI, it would measure only price changes. Whereas the in the PCE, the market basket changes with prices, so you could not tell whether the index was changing because of the price or because of the market basket.

A Well, I addressed that point earlier. Basically, the idea of an inflation index ought to be to try to attempt to measure the percentage by which a person's nominal income must increase to keep him at a constant level of satisfaction, if you will.

It would be silly, obviously, to use fixed weights if, for instance, tomorrow because of difficulties in the Middle East the price of gasoline went up to $250 a gallon. Few of us would maintain our consumption habits as they now exist if that were to occur. In fact, people would find themselves just as well off with some increase in income less than that connoted by the requirement that they spent income on 20 gallons of gasoline a week at $250 a gallon. They would substitute something for that and would be just as well off with a smaller increase in their nominal income.

The problem is that a flexible weight or current weight deflator as the PCE deflator probably understates inflation slightly. The fixed weight deflator overstates it. The difference between the period in question is relatively small for the PCE. We could put up the PCE fixed delator and you would see that it is not that much difference from the PCE current weight deflator.

The fact is there is no ideal index number.

Q You have told us quite clearly, I think, how inflation in the CPI has been over measured because of the interest rate and home ownership costs. The PCE deflator uses rentals to measure prices for home ownership. This use has been criticized by Mr. Korn. Would you comment on that and compare it with the measure of home ownership used in CPI?

A I can't comment on his criticism because I didn't hear it. There is a problem of using rental prices; that is, that because of our tax laws and the advantage of home ownership, under the tax laws because of the deductibility of mortgage increase payments.

The market for rental housing, particularly in the higher housing value category, is rather thin. That is one reason why the Bureau of Labor Statistics has traditionally been reluctant to go to a rental price measurer because of the difficulty of getting a robust enough sample.

A second difficulty arises because there is a problem in defining what is a cost of holding a house to you. In fact, you are realizing capital gains at the time. Perhaps, you want a much more elaborate user cost index which would take into account those capital gains during an inflationary period. In fact, rental prices do take those into account if imperfectly. It is not an absolutely perfect measurer but I am not sure that one can find a perfect measurer. It is certainly better than the arbitrary component in the CPI right now.

Q Now, Mr. Crandall,moving on to another comment that was made yesterday by Mr. Korn, although he recommended the use of the CPI, he entered into evidence a chart which showed that between 1975 and 1978, the expenses for syndicated television programs as reflected in some FCC data increased during that three-year period some 44 percent. Do you have a copy of this?

A No, I don't have it before me.

Q This was CO Exhibit 11.

Are you familiar with this data and how it is compiled?

A Yes, I am.

Q Can you speak to the matter of the accuracy and reliability of this figure?

A In the first place, if these numbers were measured correctly, this does not reflect a change in the price of syndicated programming per hour of programming or per hour of programming standardized for viewer appeal. That is a measurer of total flows of payments from station to program owners as reported to the Federal Communications Commission. If in fact there is more being bought over time, the FCC in it wisdom suggested that we should not get network programming for more than three hours at night and should get game shows from 7:30 to 8:00 o'clock, then we are going to get an increase in the total amounts of syndicated programming.

That generates a greater increase than the price of the program. This does not come from an uniform system of accounts. It is not exactly clear what station owners are reporting when they report. It is a bad series as reflected in a report by the Rand Corporation for FCC and completed about 1975-76.

They concluded they could not use any of the data from the form 3324 reported by stations to FCC because on serious analysis, they did not make sense. They were initially incorrect and generated non-sensible results.

It is not clear. For instance, in this case, it is not clear that people are reporting outlays for programming to be exhibited in a single year. They may be reporting outlays for three years, four years, five years in advance. You do not know what they are reporting.

MR. FELDSTEIN: That concludes my examination of this witness.

CHAIRMAN BURG: I have one question, Mr. Crandall.

Yesterday Mr. Korn gave us some examples of segments of society that used the CPI. Can you give us some examples of what businesses use or have used the PCE?

THE WITNESS: The only use of it, at the present time, that I know as a routine matter is the Bureau of Economic Analysis for deflating social accounts.

However, more and more in policy levels, both private and public people are not using the unabashed CPI index nlw-31

noticing that it is so biased because of the way it treats mortgage interest cost. Internally, either with this and this administration for which both I worked, we would not use the CPI as what is really happening in inflation. It is merely ingrained in contractual arrangements and is difficult to change. Everybody understands it is not a good measurer of the changing in the cost of living.

CHAIRMAN BURG: Understanding that they have not necessarily gone over to the PCE.

THE WITNESS: Yes. You can understand that there are serious political problems for so doing. If a contract has been assigned in which things are to be indexed under CPI and in an inflationary situation, those people who are signatory are not likely to go to more accurate forms of looking at inflation if it is going to change their standard of living.

That is from the organized labor which is an important index for this. They would probably have to continue to publish the old index for some time because grandfathers were struck because of that contract if it were changed.

COMMISSIONER JAMES: You indicated a lot of businesses are using this now as part of their consideration. Is there any documentation that you can provide us that shows the use of the PCE?

THE WITNESS: I cannot at this time. I can suggest to you in the business press now there is wide spread recognition of the fact that CPI does not measure inflation. You would not predict interest rates on the basis of CPI.

COMMISSIONER JAMES: Say that again.

THE WITNESS: There are people who attempt to predict the interest rates by predicting inflation. You certainly would not use the unadulterated CPI to do that.

COMMISSIONER JAMES: You are saying they use as a part of their predictions the PCE.

THE WITNESS: No. I am saying they understand and adjust for the fact that CPE overstates inflation. I have no evidence to bring to you the fact that people are now using PCE.

CHAIRMAN BURG: I want to give the reporter a break. Let's take a five minute recess please.

[A short recess was taken.]

- - -

etpl

CHAIRMAN BURG: Back on the record.

CROSS EXAMINATION

BY MR. ATTAWAY:

Q Mr. Crandall, you have covered almost the identical same ground as Mr. Korn did yesterday and came to a very opposite conclusion. I guess the only thing we can derive from that is that reasonable men can differ on these issues.

A Most of the things to which I testified ninety-nine point nine percent of the profession is in agreement with me about this various basis in the CPI.

Q Which was admitted by Mr. Korn. He would agree with you. You started out by saying there is no ideal index. Then you went on by saying the most commonly used index is the CPI. In response to questions from the Tribunal, you said insofar as you knew no one other than the Commerce Department was using the PCE as a deflator.

So, are you asking this Tribunal to, in effect, plow new ground with respect to the choice of an appropriate inflation index?

A I suggest that the problem is quite different now. In fact, I pointed out these two indices track one another for a very long period of time during period of low inflation in this country.

The ad hoc choice for the housing component tended to work out fairly well even though it had no sound and cyclonical basis. It is now inadequate for a period of rapidly rising

etp2

inflation. We are on a path of much higher inflation rates than the earlier '50s. I suggest to the panel they need not repeat the mistakes of the past. The fact others have used the CPI which is a, flawed index, does not mean the mistake has to be repeated here.

So far as you know if the Tribunal were to use the PCE, it would be the first organization to do so other than the Department of Commerce.

A Public organization for systematically deflating income measures, yes. I think that is correct. Although the Congressional budget office is engaged in a full fledged study of this matter, it may turn out there are other organizations using the PCE.

Q You stated in your opinion the PCE,was the more accurate and better measure. You made reference to work you did with Janet Norwood.

You said that she decided not to make any changes. Why, given the fact that PCE, your opinuon, is a better deflator, why weren't changes made?

A Janet Norwood was not the only member of the committee chaired by Burton Malcult of the Economic Advisor. I don't recall why we decided not to change the housing component. I think it is sufficient to say there would be strong political arugment against doing it. Give the technical problems of making the shift, they decided not to do it at this time. I suggest the pressures are going to forw as long as inflation stays at or near double digit. We cannot have the Bureau of Labor statistics putting out such an obviously flawed series.

Q That, nevertheless, is the series they are putting out today?

A Yes. With numerous apologies. Which would show you how this index would be if they did it slightly better.

Q Are any of these indices, particularly the CPI, the number listed there an average for the month or does it relate to a specific date in the month?

A They are for the entire month or quarter. As a matter of fact because of the bureaucratic organizational problems of obtaining observations on so many prices, some are systematically collected earlier in the month, some in the middle and the latter parts of the month.

Some of the more sophisticated forecaster of the CPI know when the things occur and are able to know what they are going to report. They are reported for the entire month.

I suppose you could say they are centered in the middle of the month.

Q If you are measuring the rate of increase in CPI between October of 1976 and April of 1980, you would use October of '76 and April of 1980 rather than March of 1980?

A Yes. If you wanted to measure through April.

Q Why is it that you only measured through March?

A Counsel for the Cable Association wanted to do it through March. I have no particular preference for any period.

etp4

MR. ATTAWAY: That is all the questions I have.

REDIRECT EXAMINATION

BY MR. FELDSTEIN:

Q On that one, that question that Mr. Attaway just aksed you, he asked you, I believe, what CPI figures, months CPI figure you would use, Mr.Crandall if you were trying to measure inflation through April. If you were trying to measure inflation through March, that is to say until April 1, 1980, would it be appropriate to move on and use the CPI for April?

A I guess if the magic date is April 1, I would want an average between the March and April figures since they both are for to the entire month. April 1, comes conveniently at the end of March and the beginning of April.

Q Mr. Crandall, you have stated that the CPI has become embedded with all of its inaccuracies in labor contracts in Social Security; is that correct?

A Yes. Not in all contracts.

Q The difficulty of changing what is known to be an inaccurate measure is caused by the vested interest involved in those unions?

A Sure.

Q In your judgment if a body such as this Tribunal in a proceeding on a first time basis, would they be well advised to avoid these errors by using a more accurate measure?

A Certainly. I think they ought to use the most accurate measure they can find for the magnitude in question.

etp5

COMMISSIONER JAMES: Again, going back to the question the Chairman asked you, you eventually see that the CPI when the political ramifications have been straightened out will become the prevailing deflator?

THE WITNESS: Not quite. We will stay with the figured weight rather than the current where they change each month. We will change housing. The PCE use a rental equivalent for monthly most of owning a home, what it would cost to rent the house.

I am not sure it would go that direction. It is a simple way to go the alternatives spelled out from the Bureau of Labor Statistics. They will go in the direction on PCE on the housing component.

Q When do you think this would probably take place, the next two three or four years?

A I would condition my estimate on how bad inflation got. This divergence is going to grow with increasing inflation and rising mortgage interests rates. If, in fact, we find ourselves on an increasing tract of inflation with mortgage interests rates going up to 15 to 20 percent, I would think the pressures would grow.

I can't predict when they would be sufficiently strong to offset pressures from the other side.

Q You agree with Chairman at such time when a gradual converse was made probably any contracts or the Social Securtiy would probably be grandfathered in in some fashion or they would publish both with an adjustment on the CPI; is that my understanding?

THE WITNESS: I am not a lawyer or expert on contracts. I would imagine there would have to be accommodations for the change. What is safely predictable is the whole CPI would continue to be published for several years after.

COMMISSIONER JAMES: Is it possible we could adopt a CPI with a provision in the vent the whole country as a whole converted to PCE, the factor would be considered at that time?

THE WITNESS: You could do that but it seems to me that is simply adopting everyone else's error until they make a change. I don't see why you have to be locked into making the same error they do.

COMMISSIONER JAMES: It's called we should bite the bullet.

Thank you.

CHAIRMAN BURG: Thank you, Mr. Crandall.

(Witness excused.)

MR. FELDSTEIN: Charlotte Beales.

MR. ATTAWAY: Madam Chairman, Mr. Korn now has those Exhibits he promised at the convenience of the Tribunal and Mr. Feldstein we can present them at anytime.

CHAIRMAN BURG: No explanations? ~~This is~~ just handing things to us.

MR. ATTAWAY: If opposing counsel would have the right to cross examination to it and the Tribunal permits, I have no objection.

etp7

MR. FELDSTEIN: You can just pass out the exhibits asfar as we are concerned.

CHAIRMAN BURG: Do you want them now, Mr. Feldstein, or later?

MR. FELDSTEIN: Certainly.

(NCTA's Exhibits 21 and 15 were marked for identification and received in evidence.)

Whereupon,

CHARLOTTE BEALES

was called as a witness and, having been previously duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. FELDSTEIN:

Q Mrs. Beales, may we have your name and your occupation?

A My name is Charlotte Beales. I am the Director of Research for the National Cable Association.

Q Could you tell us some of your past professional experience and your education?

A Prior to joining NCTA, I worked for WRC Television which is a Washington, D.C. television station, owned and operated by NBC. I was directing their activities in media and research. Prior to that, I served as Director of Research for WBBM-TV, a television station owned and operated by CBS, located in Chicago. I hold a BA in Communications with a

etp8

concentration of communications research from George Washington University.

Q As we have seen, the royalty fee per subscriber from October '76 until this date, until the end date for this proceeding is a measure which is critical to the decision which this Tribunal must make. So, we must first determine the royalty fee per subscriber in the words of the account as of the date of enactment of the account which is October 1976. Have you been able to discern this fact?

A Yes. I believe that fact is readily available in the legislative history from the time of the Act. We have included on the chart here information --

Q This is chart 3 in your soft charts?

A A copy from page91 of the legislative history. At that time as you can see, in the wording of the legislative history based on current estimates supplied to the committee, the total royalty fees paid under the initial schedule established in the bill should approximate $6.7 million. Compared with the present number of cable television subscriber calculated at 10.8 million, copyright payments under the bill would, therefore, approximate 81 cents per subscriber per year.

Q Eighty-one cents per subscriber per year was Congress' estimate of the royalty fee per subscriber.

A That is my understanding since it is printed in the legislative history.

Q Did Congress recognize that it was making a projection based on an estimate?

A That seems to be clear in the language. They include would approximate 81 cents calcuated on 10.8 million and so on. It seems to be an estimate.

Q At the bottom of the chart, further beyond in the report, was this not clarified further?

A Yes. I believe it was from page 175, the Committee recognitions, however, that no royalty fee will be paid by cable systems unless the legislation is effective on January 1, 1978, and accordingly, that that royalty fee per subscriber base calculated at the time of enactment must necessarily constitute an estimated value.

In the Committee's view and based on projections supplied by the interested parties, the total royalty produced under the fee schedule at the time of enactment should approximate $8.7 million.

Q For the sake of understanding as to how we proceed beyond this, can you gratefully demonstrate how the House Committee report arrived at the 81 cents?

COMMISSIONER JAMES: Before you get to that, can you explain to me, based on current estimates supplied to the Committee, supplied by who?

THE WITNESS: On 175, it said by interested parties.

COMMISSIONER JAMES: Who might that have been?

etp10

THE WITNESS: I know NCTA, of course, recently joined them. NCTA developed some of the information. Some of the copyright holders, understand, also provided some of the information.

COMMISSIONER JAMES: The only reason I am asking this question is that you are calling attention to it. The person at that time who would be the best person to know would be the people you currently represent?

THE WITNESS: I would assume they would have been providing the estimates. The Television Fact Book is full of drawings and figures of calculations and that says 10.8 million. I believe a lot of the figures were publicly available.

MR. FELDSTEIN: In any event, the legislative history did rely on that as a royalty fee per subscriber as of the date of enact?

THE WITNESS: Yes.

BY MR. FELDSTEIN:

Q How was that calculated?

A It is relatively simple. You take copyright payments divided by cable subscriber yielding the royalty fee per subscriber. In the case of the information supplied in the legislative history, they said $8.7 million would be collected.

At the time 10.8 million subscribers per year divided out to be 81 cents per subscriber per year. I may add all of the information I will be presenting will be on an analyzed basis.

basis. Much of the information you have heard before has been on a semiannual basis. This is so there is no confusion in the numbers. The legislative history was analyzed.

Q We are going to analyze to compare apples also with apples also becuase the legislative history had it on an analyzed basis?

A Exactly.

Q What you have here, the 81 cents is based on all systems; is that correct?

A That is correct.

Q That means those systems who pay on a DSE basis as well as those systems who pay on a smaller system dollar limitation basis?

A That is correct.

Q I presume that the royalty fee per subscriber the smaller systems is less?

A Yes. That is accurate.

Q In light of the fact that the adjustment preceding on the royalty fee per subscriber is for DSE systems only and in light of the fact the Tribunal in comparing the 1976 to 1980 will have a choicebetween using the figure for all systems and the figure for just the systems who pay on a DSE basis, were you able to break down for the 1976 date an approximation as to what the royalty fee per subscriber would have been for DSE paying systems at that time?

A Yes. We have been able to make an estimate relying upon publicly available information. You will find this is Exhibit 3B in your soft copy. You will see the results of the 1976 royalty fee per subscriber breakdown on the chart.

The all systems data which we saw from the legislative history includes $10.8 million subscriber, 8.7 million and 81 cents per subscriber figure.

The way we calculated information was to rely on publicly available data. I will give you more detail on the following chart. Basically, the small systems pay on a fixed percentage basis or a flat rate we we are able to calculate for the small systems how many they would be paying and subtracted that information from the total to yield the information for the DSE systems.

Q Now, could you please explain in a little bit more detail the back up for arriving at those figures?

A The next chart which is labeled 3B has the breakdown for the information for the small systems. We utilized two sources in deriving these estimates.

The first was the results of the Copyright Tribunal survey on the average rate charged back in '76 for the smaller systems.

We found at the time we analyzed the questionnaires in mid-July that the systems were gross receipts of less than $80,000 per year had an average basic subscriber fee of $6.16 back in etp 13

October of '76 for those between $80,000 per year and $320,006.64. The other source that we relied on in developing this information is the 1976 Television Fact Book. That is where the estimate of 10.8 million.

Q Subscribers?

A Yes. That Congress relied on.

CHAIRMAN BURG: Mr. Feldstein, I think you were referring to 3C and you said 3B.

THE WITNESS: I am sorry. I did.

CHAIRMAN BURG: Mr. Attaway.

MR. ATTAWAY: Are you including that Congress relied on the fact book in its estimate? If you are, I would like to see some basis for that conclusion.

THE WITNESS: Perhaps, they did not rely on it. I know the 10.8 million subscriber figure appears in the 1976 Fact Book. Perhaps, it is a coincident they estimated the same amount. Since they used that, I believe, we could project out.

BY MR. FELDSTEIN:

Q The estimates that Congress relied on in passing the Act in 1976, in your opinion, would they be based on the data that was then available in 1976?

A I believe that would be the case.

Q The publicly available data on subscriber system sizes and such data was commonly available in which source?

A The Television Fact Book has been relied on for

etp14

information about our industry pretty consistently over the last few years.

Q It should be pointed out to the Tribunal that this breakdown we are doing in order to establish the royalty fee per subscriber for large systems as opposed to all systems is our estimate, not what Congress did. Congress had an estimate for all systems which we will assert should be utilized by the Tribunal.

This breakdown is only being done in the event the Tribunal decides it wants to use the figures for only the DSE paying systems.

Proceed, please.

A There is a chart available in the 1978 Fact Book entitled Systems by Subscriber Size. It will tellyou how many systems have subscribers in the range of 500 to 1,000 subscribers and so on.

We utilized this chart to get an estimate of the number of systems who would fall in each of these categories and how many subscribers they would have. Once we derived those estimates, it was a relatively simple matter to find the royalty fee.

Of course, we were making some assumption. We assumed all 1,500 systems paid $30 per year. Fifteen on a six-month payment period. But $30 per year to arrive at this royalty fee as you will see in your footnote.

etp15

The next category 80,000 to 160,000, we calculated the royalty fee based on one-half of one percent of the total gross revenues. Then in the third category, since the law provides for a sliding scale, we assumed a payment of two-thirds of one percent in this category.

Once we were able to derive each of these estimates, we added them up. As I indicated on the prior chart, we subtracted these totals from the totals mentioned in the legislative history to give us an estimate of the DSE systems' payments and the royalty fee per subscriber so we could have some kind of breakdown and we could make direct comparisons.

Q This shows us how we got the 1976 estimate as to what it was based on what Congress said it would be for all systems. It shows how we got it for the large systems.

What is the most recent period for which we can calculate the royalty fee per subscriber as of this date.

A The most recent information that I could find was the statement of account forms filed at the Copyright Office along with the copyright payments for the period 1979-2, the last six months of 1979. The last complete information available.

Q Does that statement of account form ask for information as of what date?

A The end of 1979, December 31, 1979. That takes us up to the beginning of this year.

Q Would you explain to us what you have done and what you have arrived at?

etp16

A In our analysis of the statement of account forms that were available in the public information file in early September, we analyzed 3,756 forms. We found that these forms contained a reported subscriber number of almost $14 million, they paid $7.5 million in total royalty payments on a semiannual basis.

That computes out to a royalty fee per subscriber or 54 cents annually is $1.08, for the most recent period available.

COMMISSIONER JAMES: Did you do this in-house or did you send it out to be done?

THE WITNESS: In-house.

BY MR. FELDSTEIN:

Q In doing this since you looked at all of these statements of account forms, Mrs. Beales, I note that there is $7.4 million of total royalty payments appearing here. How much in total was paid during that period?

A Well, apparently, if the number of is not final. That is at this point. The last update I received from the Copyright Office which I received $8.1 million.

Q That is $8.1 million collected for '79?

A That is correct.

Q There is a difference between 74 and 81. What do you attribute this to?

A Several factors. We utilized the statement of

etp17

account forms in the public information file. At the time I analyzed the file, I found 3,858 forms in the file. There is a difference. I am sure the Copyright Office. I don't work at the Copyright Office. I would assume some of these are in processing or because these are copies that appear in the public information file, perhaps, some have been misplaced.

We analyzed a total of 3,858 forms. We rejected 102 forms from our sample to finally arrive at the figure of 3,756. We rejected these because in several cases there were obvious duplicates in the copying process, or again, in the process of copying, the page with the number of subscribers would be missing or illegible or something like that.

Finally, there were some systems that did not report their subscribers in an accurate way although that was a small part of the total. We arrived at the final total of 3,756 forms.

Q The answer is at this point $1.08 royalty fee per subscriber as of December 31, 1979?

A That is correct on an industrywide basis.

Q Were you able to break this down so we can see a DSE paying system figure?

A Yes. It was relatively easy to do because we worked with statement of account forms which are filed Form 1, 2 or 3. In the next chart which is 4A, we have the current cable industry royalty fee paid per subscriber reported by gross receipts categories utilizing 1979 information. As you can see for DSE systems a gross receipt of more than $3,020. We analyzed 1,015 forms. The reported subscribers were over 10 million. Royalty $6.9 million which devided to royalty fee per subscriber of 64 cents or analyzed $1.28.

Q Thus, it is $1.08 for all systems and $1.28 for the DSE paying system?

A That is correct. The calculation for smaller systems is also included. Forty-eight cents for medium size and six cents for systems paying on a flat rate basis.

Q The next chart is Exhibit 5 in the soft pack. Can you explain this chart to us?

A Well, we gathered the information for 1976, from the legislative history which told us the royalty fee per subscriber estimated at the time of enactment was 81 cents. We have now seen from the royalty fee per subscriber is $1.08, which is an increase of 33 percent.

I have also included on this chart for your comparison, the information provided by Mr. Crandall in terms of the PCE deflator which has gone up almost 31 percent for that same period of time.

Q If we were to use it, if the Tribunal were to use the royalty fee per subscriber for only the SE systems, ~~which~~ we have seen calculated for both 1976, and the end of 1979, what are those comparative numbers and percentages?

etp19

A Back '76, based on our estimate, we came up with 91 cents for the most recent period we reported up to the end of '79, we had $1.28 for an increase of 31 percent. Very similar to the increase for all systems.

Q For all systems in '76, it was 98 cents?

A Yes. And increased to $1.28, which is an increase of 31 percent.

Q Did you make any effort to check although no relevance to the determination that the Tribunal must make, along a midpoint to see what the copyright royalty payment per subscriber was at an earlier time?

A Actually, this was a byproduct of another study we conducted. But it gave us a checkpoint as to what happened in the first reporting period when cable systems started paying copyright fees in 1978.

We have the estimate for 81 cents which increased to $1.08. The information we have for the first period was royalty fee per subscriber was about 98 cents. This was a sample of 100 random forms filed at the Copyright Office and gives us a checkpoint of the information.

One important point to note in the clear trend line is this information although the law was enacted back in October of 1976, the information was earlier. According to the estimate printed in the fact book, the first of the year in 1976. So, we have 30 months in between this period, the information for

etp20

1976, as in all of the reporting periods of the statement of account forms is the last day of the reporting period. For this portion of the trend line, we have 30 months.

We have an increase of about 20 percent. For the remaining months, we have an increase of about 10 percent. We have a pretty good trend line here.

Q Now, we have seen that the royalty fee per subscriber has increased. We have been able to demonstrate that. In order for the Tribunal to understand what could have contributed to this actual increase in the royalty fee per subscriber have been able to come up with any explanations?

Do you have any explanations for this?

A Yes, I do.

I have been able to identify four components that would contribute to an increase, may contribute to an increase in the royalty fee per subscriber.

Q Can you name those for us?

A Certainly.

The first one and most obviously is the change in the basic subscriber rate. We have seen some information presented about this. We will develop further information. There are three additional factors that I believe if they were to increase they would contribute to an increase in the royalty fee per subscriber. The second factor is a change or increase in the additional receipt revenues that cable systems pay as part of

etp21

their gross receipts. The third factor would be an increase in the DSE equivalent which are reported and paid on by cable systems.

The fourth would be an internal growth within cable systems that would move the system out of one payment class and into another. From payment class 2 to 3, where we have already seen the royalty fee per subscriber rate is different for those categories.

Q Now the first of the four factors which you named, were the increases in rates four basic conditions for subscriber the basic subscriber rate for retransmission service.

A Yes.

Q Were you able to measure that for the full period under review?

A Yes.

Q Can you explain to us on your chart Number 7, the results which you have reached and how you have done this?

A Certainly.

There is a tabulation of the responses to the Copyright Tribunal's royalty questionnaire. These responses were tabulated as of July 15. So, I am recording a lower number than some of the evidence you have seen although all of the numbers are remarkably similar.

I have utilized a somewhat different methodology that I think will enable you to see another dimension of the

etp22

responses to your survey. As you can see on the chart we have a number of systems reporting and the basic subscriber rate as an average back in October 19, 1976. We have a rate of $6.69, for the DSE systems, $6.64 for the small systems with gross receipts of $80,000 to $320,006.16, for the smaller systems with receipts of less than $80,000.

That is a total of 1,673 forms. By April 1980, we have seen a considerable increase. I have counted all reponses to that question. We have a measure of the new systems that came on line sometime during the period. You will recall in some data that we have seen, there was only a comparison between the same systems between '76 and 1980.

We have an additional factor of the new system. In April 1, 1980, we analyzed 1,939, forms and saw $7.63, for DSE, $7.67, for middle systems and $7.23.

We saw increases of 14 percent for DSE, 14 for middle systems and 17 percent for the smaller systems.

CHAIRMAN BURG: Slow down, please.

THE WITNESS: Overall an increase of 15 percent.

COMMISSIONER GARCIA: In looking at these figures that you just gave me and comparing them to your schedule 3C for October '76, two on the one less than $80,000, is there a typo?

THE WITNESS: No. That is actually accurate. We found, as you will see on the chart for the tiny system, $80,000 tp23

and less $6.16. The way the Tribunal's forms were separated, it was recorded as intermediate size forms. We have the whole category average of $6.64. On chart 3C, we had to make a division between 80 to 160 category because they pay on a different basis. One pays half a percent while the other pays a full percent above 160,000.

So, it is the same rate broken down twice in the calculation on 3C.

BY MR. FELDSTEIN:

Q What are you saying is this figure 80 to 320 at a $6.64 rate on 3C is simply broken down into two categories. Is that correct?

A Yes, 80,000 to 160,000 and 160,000 to 320,000.

COMMISSIONER GARCIA: Is that the reason we have more systems? At 3C you stopped and 330, you exceed 320?

THE WITNESS: Yes. I included the systems with gross receipts of more than 320,000 on 3C. I used the responses of the Tribunal. The other information was generated from the Television Fact Book I mentioned earlier.

BY MR. FELDSTEIN:

Q So, you have presented new data as to the rates of new systems April 1, 1980?

A Yes.

Q Have you also -- my recollection was the data presented by the copyright owners' off the CRT survey was for DSE

etp24

systems only; is that correct?

A That was my impression.

Q Therefore, you have also collected data for the smaller systems?

A That is correct.

Q For the first time, we have information on the rate increases for the smaller system?

A That is correct.

One other point I might make about this chart, Mr. Feldstein, is that this increase of 15 percent that we find with the Copyright Tribunal questionnaire responses is very similar to the responses we found from a survey that we commissioned at the A. C. Nielsen Company to conduct. They randomly selected 150 cable systems nationwide to ask the same questions.

They came up with a response of just under 16 percent. We see a lot of information to see this as the rate.

Q You have identified three other components of the increase in the royalty fee per subscriber. We are unable to track any of these back to 1976?

A Unfortunately, I was not.

Q Is this because data on these are simply not available?

A I was unable to find data back in 1976. For example, on the next chart when we are going to be talking additional receipt revenues, the Tribunal did not ask for additional revenues.

etp25

So, we don't have a checkpoint.

Q Thus, what you are about to tell us about the three additional components therefore are indications; is that correct?

A That is correct.

Q Not specific quantifications?

A Yes.

I want to make that point very clear. We are not trying to pin a specific figure increase on the next three components. We are only presenting an indication that these components may have increased thus contributing to the increase of the royalty fee per subscriber that we have documented already.

Q We have seen inflation has gone up either 30.6 or 39 percent depending on the measure chosen. We have seen that pursuant to your data and pursuant to copyrighter owners' data, basic subscriber rates have gone up approximately 15 percent?

A That is correct.

Q Therefore, are you saying that the difference since the royalty fee per subscriber went up over 30 percent, must therefore be explained by other factors?

A It would appear to me that that would be the case. The 15 percent may not directly translate to 15 percent of 30 percent increase that we have already shown but it would certainly that portion of it would be the major contributor, I would imagine. There must be some other factors.

etp26

Q Have you done something to see whether any of these other factors you have been able to identify may well have arisen in the time period?

A Yes. I have some indications that these other factors have increased.

Q Would you please explain the first one?

COMMISSIONER JAMES: Before you go on. Let's go back to 1976, and this estimate. Did I just understand you to say there is no way you can actually tell what payments would have been made in 1976?

THE WITNESS: I did not attempt to do that because it was provided in the legislative history. It said quite clearly that they estimated --

COMMISSIONER JAMES: Is there any way we can actually find out what the payments would have been?

THE WITNESS: I don't believe that I could do that.

COMMISSIONER JAMES: Go back to chart 3. If the estimate should have been 15 million and you knew you had 10.8 subscribers you would have had a different figure?

THE WITNESS: Correct.

COMMISSIONER JAMES: Is there any documentation to show that Congress was right in their estimation? You keep harping on the $8.7 million. It is an estimate, an approximation. Is there something in your records because it is your industry that would clearly and unequivocally indicate

etp27

what that actual figure was? As I keep going through your things, you keep coming back to 81 cents. It does not deal if we start out with a faulty figure to begin with. Congress is not holier than thou. 8.7 was an estimate. What was the actual figure? If it was 10 million or 15 million, you would have a different figure, wouldn't you?

THE WITNESS: I was not involved in the 1975-76 process that yielded this estimate. In looking through the work sheets and files at NCTA, I found that estimate was based on currently available information is how it was sourced.

I do not. I think perhaps other people could speak better to this. An additional point I think you have to remember is we do have the checkpoint for 1978 one. When cable systems started paying copyright. That goes in a clear trendline and the increases seem to fall in a consistent pattern. We have some indication that it is part of a trend.

COMMISSIONER JAMES: I don't want to say play that way but repeat that again for me?

THE WITNESS: Chart 6. We have an indication at the midpoint of this period or somewhere in the midpoint that based on my sample of 100 statement of account forms filed with the Copyright Office in that first reporting period, the royalty fee per subscriber was 98 cents.

That falls in a consistent trendline with the other information we have available.

COMMISSIONER JAMES: Only if you assume that the first thing was right. I can't assume that because you have not given me direct evidence to support outside of what is in the Congressional Record. You say you went back and reviewed a lot of the figures you inherited?

THE WITNESS: Yes.

COMMISSIONER JAMES: They did not indicate anything more than an approximation?

THE WITNESS: In all honesty I can't say I remember all of those worksheets. I have not reviewed them since we started this process in preparing for the hearings. In talking with other parties involved and looking at the worksheet, I see the consistent repetition of $8.7 million.

COMMISSIONER JAMES: That may have been stuck in everybody's mind. In applying the rate to the figure conceivable to you, could you not come up with a different rate than 8.7? You get 81 by dividing 10.8. If you use another enumerator, you have a higher figure than the 81 cents?

THE WITNESS: That is true. I do know in '75-76, I have indications that there was an estimation made of the number of systems that would be paying in each category and the number of systems and the DSE category or an estimation of how many DSEs there would be.

That was based on samples that were taken, a fact book data available. Actually looking at all the cable

etp29

systems and seeing what their gross receipts were, monthly subscriber charge and how much subscribers they had. They went through numerous calculations and came up with this estimate.

Again, I was not a participant. I can only look back at the worksheet and see they had these calculations. I can look back at four or five-year old worksheets.

COMMISSIONER JAMES: Can't you take our survey? Does our survey under your qualifications --

THE WITNESS: Your survey did not ask about royalty fee paid.

MR. FELDSTEIN: Possibly, I can help you by asking a couple of clarifying questions.

COMMISSIONER JAMES: Please do.

BY MR. FELDSTEIN:

Q The data in order to calculate under the Act how much copyright would be paid, was cable paying copyrights in 1976?

A Not to my knowledge.

Q When did Cable first have to file statement of account forms?

A In the first period of 1978, first six months.

Q Did Congress recognize that Cable was not yet paying copyright when it enacted this Act?

A Yes. It specifically mentioned that in the legislative history.

ETP30

Q Did Congress recognize that it did not have nor could it have the data available to make an exact calculation?

A Yes. That seemed clear from the wording of the legislative history.

Q Does the legislative history, therefore, rely on an estimate?

A Yes.

Q Does the Act talk about a royalty fee per subscriber as of the date of enactment?

A Yes.

Q Therefore, does not the legislative history say as you stated from the legislative history look back at your chart 3. We can refer to the soft charts.

Can you read to us from the third line to the end of the sentence?

A Page 91?

Q 175. In the Committee's view and based on projections.

Q No. The third line from the top of page 175. And accordingly that the royalty per subscriber may be calculated at the time of enactment must necessarily constitute an estimated value.

Q In other words Congress was unable to do other than use an estimated value?

A That is correct.

etp31

Q Therefore, since Congress was unable to do that in 1976, the CRT and NCTA are unable to reconstruct what Congress in 1980, what Congress could not do in 1976.

A I have not been able to do that.

CHAIRMAN BURG: I think this is an appropriate time to conclude for today. We will adjourn until 10 o'clock tomorrow morning.

THE WITNESS: I would make a correction on my remarks. The one time adjustment in our proposal was several million dollars. In revised exhibit the difference is $16.8 million.

CHAIRMAN BURG: We are adjourned.

(Whereupon, at 4:20 p.m., the proceedings were adjourned, to reconvene at 10 a.m., Wednesday, October 1, 1980.)